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Supreme Court, U.S.
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In the

Supreme Court of the United States

AMERICAN MOTORISTS INSURANCE COMPANY,

Petitioner,

v.

GTE CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI FROM THE SUMMARY ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT ENTERED FEBRUARY 25, 2002

PETITION FOR WRIT OF CERTIORARI

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68 pgs

QUESTIONS PRESENTED FOR REVIEW

1. GTE willfully abused the discovery process in the *Nunn* lawsuit by failing to produce crucial documents and by inaccurately answering interrogatories. Did AMICO state a valid cause of action for breach of the provision of the insurance policy requiring GTE to cooperate with AMICO in the defense of the *Nunn* lawsuit?

2. The sanctions against GTE in the *Nunn* lawsuit included a ruling that GTE would be held liable for at least fifty percent of any jury verdict. The party believed truly at fault, Falconer Glass, and GTE's other co-defendants were thus allowed to escape a substantial portion of their liability. Did AMICO state a valid cause of action for breach of the provision of the insurance policy that requires GTE to do nothing after a loss to prejudice AMICO's rights of subrogation?

3. GTE committed willful discovery abuses in the *Nunn* lawsuit, causing the trial court to severely sanction GTE. The sanctions included a finding of liability and completely compromised GTE's ability to defend what otherwise was a defensible case. Did AMICO state a valid cause of action that public policy prohibits insurance coverage for the settlement of the *Nunn* lawsuit, which was tainted by and the result of the sanctions imposed on GTE for its willful discovery abuses?

4. The plaintiff in the *Nunn* lawsuit intended to seek punitive damages from GTE. The trial court's sanctions included a jury instruction that GTE had notice of potential defects in its products at the time of the accident, laying the foundation for a punitive damages award. Did AMICO state a valid cause of action that the public policy of the State of New York prohibits insurance coverage for that portion of the settlement of the *Nunn* lawsuit that disposed of GTE's exposure to punitive damages?

5. Did the Second Circuit err in failing to certify one or more of the foregoing questions to the New York Court of Appeals?

LIST OF PARTIES TO THE PROCEEDINGS

The parties who participated in the proceedings before the Second Circuit and the District Court are the same as appear on the caption of this Petition For Writ of Certiorari. They are as follows:

American Motorists Insurance Company

GTE Corporation

Verizon Communications, Inc. (the parent company of GTE Corporation)

RULE 29.6 STATEMENT

In accordance with U.S. Sup. Ct. Rule 29.6, Appellant-Petitioner states that American Motorists Insurance Company, on whose behalf this proceeding has been brought, does not have any publicly owned corporate parent, subsidiary, or affiliate, nor does a publicly held company own 10% or more of American Motorists Insurance Company's stock.

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PETITION FOR A WRIT OF CERTIORARI

Appellant-Petitioner, American Motorists Insurance Company ("AMICO"), respectfully prays that a Writ of Certiorari issue to review so much of the judgment of the United States Court of Appeals for the Second Circuit ("Second Circuit") entered on February 25, 2002 as holds (i) AMICO has not set forth any valid claims, (ii) Appellee-Respondent, GTE Corporation ("GTE"), has made its case for judgment on the pleadings and for attorneys' fees, and (iii) the United States District Court for the Southern District of New York ("District Court") judges' dismissal, judgment on the pleadings, and grant of attorneys' fees is affirmed.

OPINIONS BELOW

The February 25, 2002 Summary Order of the Second Circuit, which is unreported and cited as 30 Fed.Appx. 15, is reprinted as Appendix A. *See American Motorists Ins. Co. v. GTE Corp.*, 30 Fed.Appx. 15, 2002 WL 275214 (2nd Cir. 2002). The February 25, 2002 Summary Order affirms the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment.

The District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment, which are unreported, are reprinted as Appendices B and C, respectively.

Reprinted as Appendix D is the Honorable Kimba M. Wood's unreported August 4, 1999 Order of the District Court, which granted in part GTE's Motion to Dismiss and Motion for Judgment of the Pleadings.

Reprinted as Appendix E is the Honorable Richard C. Casey's unreported September 25, 2000 Order of the District Court, which granted GTE's Motion To Dismiss and Motion For Judgment on the Pleadings. *See American Motorists Ins. Co. v. GTE Corp.*, 2000 WL 1459813 (S.D.N.Y. 2000).

JURISDICTIONAL STATEMENT

The Summary Order of the Second Circuit was entered on February 25, 2002. (Appendix to the Petition For Writ of Certiorari of Appellant-Petitioner, at A-1–3 (hereinafter referred to as "A-___")). This petition is filed within ninety (90) days of the date the Second Circuit entered its February 25, 2002 Summary Order.

The jurisdiction of this Court to review the Second Circuit's judgment on petition for certiorari rests upon 28 U.C.S.A. §§1254(1) and 2101 and upon U.S. S.Ct. Rule 10, as review on a writ of certiorari will be granted for "compelling reasons." The Second Circuit incorrectly affirmed the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment and, in doing so, failed to follow an applicable New York case that was decided only after the rulings by the District Court. (A-3) Because the Second Circuit's February 25, 2002 Summary Order is a clear departure from current New York law and establishes perverse incentives for insured litigants to violate discovery rules, there are many compelling reasons for this Court to grant review. Important questions of law and public policy are raised by this appeal and should be settled by this Court.

STATUTES INVOLVED

Not applicable.

STATEMENT OF THE CASE

After GTE tendered a wrongful death claim to AMICO, AMICO agreed to pay for GTE's defense of that claim. During the course of the underlying lawsuit, pending in New York state court, it was judicially determined that GTE willfully withheld from discovery critical evidence requested by opposing parties. As a result of GTE's willful misconduct, the trial judge presiding over the underlying lawsuit imposed severe preclusive sanctions on GTE. AMICO paid for GTE's unsuccessful appeal of the sanctions order. Due to the pre-

clusive sanctions, GTE's otherwise strong liability defense and contribution claims were effectively lost, prompting AMICO to withdraw from the defense and deny any indemnity obligation. GTE then paid $4,500,000 to settle the wrongful death lawsuit.

Despite GTE's improper conduct, it has demanded that AMICO provide indemnity for the settlement payment. AMICO has no duty to indemnify GTE in this matter for three reasons. First, GTE breached the cooperation condition of the AMICO insurance policy by willfully failing to gather and produce evidence during the defense of the underlying wrongful death lawsuit. Second, GTE breached the subrogation condition of the AMICO insurance policy by incurring sanctions which permanently prejudiced AMICO's rights of subrogation against the parties truly at fault in the wrongful death lawsuit. Third, public policy of the State of New York — and every other jurisdiction, for that matter — should not permit insurance coverage for a settlement payment tainted by and the direct result of the sanctions imposed to punish willful discovery abuses.

Separately, AMICO has no duty to indemnify GTE for that portion of the settlement payment eliminating GTE's very real exposure to punitive damages in the underlying wrongful death lawsuit. Under New York law, like many other jurisdictions, punitive damages are not insurable as a matter of public policy. All or part of any settlement reached to avoid punitive damages should also be held uninsurable.

AMICO made each of these well-reasoned arguments in its Complaint for Declaratory Judgment and Other Relief ("Complaint") and its Amended Complaint for Declaratory Judgment and Other Relief ("Amended Complaint") before the District Court. Jurisdiction of the District Court was properly based upon 28 U.S.C.A. §1332 as this is a civil action involving citizens of different states and an amount in controversy exceeding $75,000 exclusive of interests and costs.

The District Court incorrectly concluded that AMICO's arguments were without legal merit and dismissed AMICO's Complaint and Amended Complaint. (A-32) AMICO thus appealed to the Second Circuit, seeking the reinstatement of its Complaint and the opportunity to prove its case. AMICO appealed from the August 4, 1999 Order of the District Court (Honorable Kimba M. Wood), the September 25, 2000 Order of the District Court (Honorable Richard C. Casey), the October 3, 2000 Judgment of the District Court (Honorable James M. Parkinson) and the February 27, 2001 Amended Judgment of the District Court (Honorable Richard C. Casey), which granted Defendant-Appellee's Motions To Dismiss and Motion For Judgment on the Pleadings. (A-1–32)

On appeal to the Second Circuit, AMICO cited a recent New York Appellate Division decision, decided on very similar facts, which supported AMICO's position that GTE had breached the subrogation condition of the AMICO insurance policy. This decision was not rendered until June 28, 2001, well after the District Court had dismissed AMICO's Complaint and Amended Complaint. Thus, the Second Circuit should have carefully considered the merits of AMICO's appeal without undue deference to the decision of the District Court. On appeal, AMICO also requested certification of several questions of law to the New York Court of Appeals since there was very little precedent on the disputed issues.

On February 25, 2002, the Second Circuit entered a Summary Order affirming the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment in their entirety for the reasons given by the District Court in its opinions. (A-3) The Second Circuit did not issue an opinion and, thus, did not offer any explanation as to why the new New York Appellate Division decision cited by AMICO was not controlling. (A-3) Nor did the Second Circuit even address AMICO's motion for certification of questions of law to the New York Court of Appeals. (A-3)

Accordingly, AMICO now petitions this Court for redress of entry of the Summary Order and once again seeks reinstatement of its initial Complaint and an opportunity to prove its case. AMICO has simultaneously filed a Motion To Stay Execution and Enforcement of Judgment before the District Court pending final disposition and resolution of this case.

SUMMARY OF FACTS

I. AMICO DEFENDS THE *NUNN* LAWSUIT

Stephen R. Nunn was injured in an explosion on February 29, 1988, while attempting to repair certain electrical switch equipment at his place of employment, Falconer Glass Industries, Inc. ("Falconer Glass"). The explosion occurred in or near a low voltage switchboard ("QSF-C switch"). Mr. Nunn suffered severe burns and endured extreme pain until his death, which came approximately thirty days after the accident. Dangerous electrical wiring maintained by Falconer Glass and/or a defective QSF-C switch manufactured by GTE allegedly caused the accident.

In April 1989, a lawsuit styled *Estate of Steven R. Nunn v. GTE Sylvania, Inc., et al.*, Index No. C-11012, was filed in the New York Supreme Court, Chautauqua County (the "*Nunn* lawsuit"). This lawsuit sought damages for the bodily injuries to and wrongful death of Mr. Nunn. GTE tendered its defense of the *Nunn* lawsuit to AMICO, its commercial general liability insurer. AMICO agreed to reimburse GTE for the costs of defense and indemnity arising out of the *Nunn* lawsuit. GTE and two of its co-defendants named Falconer Glass as a third-party defendant in the *Nunn* lawsuit.

GTE's trial attorney, Mr. Kohane, prepared a Pretrial Report for AMICO, dated November 3, 1997. In the Pretrial Report, he concluded Falconer Glass was clearly most liable for the accident, while GTE's liability was questionable. Mr. Kohane characterized the actions of Falconer Glass as approaching or constituting "criminal negligence":

The cause of the accident is unknown, but there are several theories. The explosion occurred in a control room behind a control panel which operated a furnace. There was a panel of switches, including a vertical panel which contained two 200 amp. fuses above two 400 amp. fuses, enumerated 6, 7, 8 and 9 respectively (from top to bottom). Several months before the accident, Falconer Glass was having a problem with one of the lower 200 amp. switches, switch number 7. **In what can almost be described as an act of criminal negligence, Falconer Glass re-wired the switch so it would be laying, unprotected, outside of the switchboard, on the floor below.** The switch was connected by a cable to an area outside of the cabinet, which contained the other switches. The cabling for that switch was all external to the cabinet. The cabinet door for switch seven remained open, therefore, with the cabling coming down towards the floor, directly in front of the lower switchboard doors.

For reasons still unclear, Falconer never got around to replacing that switch within the cabinet over the several months before the accident. About a year before the accident, employees of Falconer experienced problems with switch number 8, the upper of the two 400 amp QSF switches. Apparently, someone tried to open the door of that switch and the door handle was broken. Again, Falconer's indifference led to no activity undertaken to repair that switch, despite warnings that it was an "accident ready to happen." [emphasis added]

II. THE AMICO POLICY

AMICO issued comprehensive liability insurance policy 3YM 578 330-00, effective July 1, 1986 to July 1, 1989 (the "AMICO policy"), to GTE. AMICO agreed to defend GTE in the *Nunn* lawsuit under this policy. GTE now seeks indemnification for the amount it paid to settle that case under this policy.

Condition 5 of the AMICO policy, a common provision found in liability insurance policies, requires the assistance and cooperation of GTE in the defense of lawsuits:

> ASSISTANCE AND COOPERATION OF THE INSURED
>
> The insured shall cooperate with the company and, upon the company's request, shall attend hearings and trials and shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits. . . .

Condition 9 of the AMICO policy, also a common provision found in liability insurance policies, requires GTE to protect and preserve AMICO's subrogation rights:

> SUBROGATION
>
> In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefore against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing, after loss to prejudice such rights. . . .

III. THE SANCTIONS FOR GTE'S WILLFUL DISCOVERY ABUSES

During the course of the *Nunn* lawsuit, a dispute arose because GTE failed to produce critical information and documents requested by the plaintiff and by third-party defendant Falconer Glass. The Estate of Mr. Nunn moved for a preclusion order against GTE on September 4, 1997. GTE's co-defendants B&E Electric Corp. and Glass Tech, Inc. and third-party defendant Falconer Glass filed similar cross-motions for preclusion.

A hearing on the motions for preclusion was held before New York Supreme Court Judge Joseph Gerace on January

12, 1998. Plaintiff argued that GTE willfully redacted documents. One of the co-defendants asserted that GTE had additional files regarding QSF-C litigation at the time it responded to discovery, but failed to produce them. In oral argument, Dalton Burgett, plaintiff's trial counsel, stated, "Judge, I think I'm entitled to have my complaint amended to add a punitive damage charge, I really do, and I'm going to ask you to consider that, and I'm also going to ask for a preclusion and the defendant's answer be struck."

At the January 12, 1998 hearing on the motions for preclusion, GTE's trial counsel stated in open court that the contemplated evidentiary sanctions were the equivalent of a monetary sanction or "fine" in the amount of the undisputed damages sustained by Mr. Nunn:

> Of course, Your Honor, I'm not — and I'm not suggesting by any means that your orders were improper or overreaching. I'm not suggesting that at all. But they missed them, Judge, they missed those boxes, and when the Court — when we found those — that schedule, we went back and we found when we produced them. Is that a million-dollar sanction, Judge? Is that a million-dollar mistake? I suggest to you, Your Honor, that the nature of the requested relief given without any evidence of willfulness is — is a horrendous penalty against my client. It is a horrendous penalty to say you, GTE, here it is years after this lawsuits commenced, without yet an expert saying what the problem was that caused this explosion, and we can get into my theories on it, Judge, we've discussed it at various other times of what my theories are on the cause of this thing, which had nothing at all to do with the GTE switch. We can get into it, but not here and now, but what this Court would be doing would be penalizing GTE to the tune of whatever Mr. Burgett can prove up in damages, and we know it's a horrible case in terms of injuries, we know that.

> This man was burned. He lived for thirty days. He died. Um, it was a very unfortunate death, and it's a case that — that if there was liability, could be worth a good deal of money. What Mr. Burgett wants is he wants to avoid having to prove his case, and he says penalize GTE to the tune of a million dollars or two million dollars for this, Your Honor. I suggest to you that penalty would be way in excess of what sanction the Court might consider imposing if the Court decides to impose one. A million-dollar sanction, Judge, it — I would humbly and respectfully request would be grossly unfair.

Judge Gerace issued a Memorandum Decision dated January 26, 1998, severely sanctioning GTE for its **willful** discovery abuses. As a sanction for GTE's willful discovery violations, GTE was precluded from introducing evidence that its products were not defective. GTE was also precluded from refuting any testimony of proximate cause. The end result of these sanctions was that the jury was to assume GTE was negligent and its products contributed to the accident leading to Mr. Nunn's death. It was further ordered that GTE's percentage of liability would be deemed to be at least fifty percent of the total liability, and that the jury would be so instructed. Finally, laying a foundation for punitive damages, it was ordered that the jury could be instructed that GTE had notice of potential defects in its products and was aware of those defects at the time of the accident.

In his Memorandum Decision, Judge Gerace expressly concluded that GTE's discovery abuses were **willful**. In a subsequent Decision and Order dated February 18, 1998, Judge Gerace incorporated and discussed at length the factual bases for the preclusive sanctions and his findings of **willfulness**.

On or about February 19, 1998, GTE filed a Notice of Appeal of Judge Gerace's February 18, 1998 Decision and Order to the Appellate Division of the Fourth Judicial Department

of the Supreme Court of the State of New York. AMICO paid for GTE's appeal. On June 10, 1998, the Appellate Division issued a unanimous decision affirming Judge Gerace's Decision and Order.

IV. AMICO WITHDRAWS FROM THE DEFENSE OF THE *NUNN* LAWSUIT

Prior to the ruling by the Appellate Division on the sanctions imposed upon GTE, AMICO reserved its rights to deny coverage for the consequences of any sanctions ultimately upheld against GTE. After the sanctions and the finding of willful discovery abuses were affirmed on appeal, AMICO withdrew from the defense of the *Nunn* lawsuit and denied a duty to indemnify GTE for any judgment or settlement that might result. AMICO issued a letter to GTE setting forth the reasons for its withdrawal from the defense and denial of coverage.

V. THE SETTLEMENT OF THE *NUNN* LAWSUIT

The November 3, 1997 Pre-Trial Report of Daniel D. Kohane, Esq. provides an analysis of the *Nunn* lawsuit, including likely settlement scenarios. In the section of the Pretrial Report titled "Probability and Percentage of Plaintiff's Verdict and Verdict Range," Mr. Kohane estimated that "plaintiff has a 40% to 50% chance of obtaining a plaintiff's verdict." Mr. Kohane estimated "the potential verdict range as between 2.5 and 4 million dollars." In the section of the Pretrial Report titled "Present Demand and Offer; Evaluation and Settlement Recommendations," Mr. Kohane stated:

> The plaintiff's current demand is $5,000,000. There have been no offers. An attempt to reach an agreement in which Falconer Glass would agree to pay a substantial majority, perhaps 80%, of any verdict received, thus allowing all defendants to pursue a joint defense, has been unsuccessful.

Thus, under GTE's own analysis in late 1997, 80% of the $5,000,000 demand, or $4,000,000, was properly owed by Mr. Nunn's employer, Falconer Glass. The remaining 20%, or $1,000,000, was to be paid by the remaining defendants in the *Nunn* lawsuit collectively.

Shortly after the Appellate Division of the Supreme Court of the State of New York affirmed the sanctions in June 1998, the *Nunn* lawsuit was settled for $5,000,000. GTE contributed $4,500,000 towards the settlement. Falconer Glass contributed only $500,000.

VI. THE DECLARATORY JUDGMENT ACTIONS

On January 25, 1999, AMICO filed a four-count Complaint for Declaratory Judgment and Other Relief against GTE, seeking a declaration that AMICO was excused from further performance under the insurance policy issued to GTE. In Count One, AMICO alleged that GTE had breached the cooperation condition in the insurance policy by willfully failing to fulfill its discovery obligations in the *Nunn* lawsuit ("Cooperation Defense"). In Count Two, AMICO alleged that GTE breached the subrogation condition in the insurance policy because the sanctions GTE brought upon itself prejudiced AMICO's rights of subrogation against Falconer Glass and the other co-defendants ("Subrogation Defense"). In Count Three, AMICO alleged that the public policy of the State of New York prohibits insurance coverage for the settlement of the *Nunn* lawsuit because that settlement was tainted by and the product of the sanctions for willful discovery violations ("Public Policy Defense"). In Count Four, AMICO alleged that the public policy of the State of New York prohibits insurance coverage for that portion of the settlement of the *Nunn* lawsuit eliminating GTE's exposure to punitive damages ("Punitive Damages Defense").

GTE filed its own declaratory judgment action ("GTE's Complaint For Declaratory Judgment") against AMICO on

March 24, 1999 for alleged breach of the insurance contract. On June 16, 1999, AMICO filed its Answer to GTE's Complaint For Declaratory Judgment and Counterclaim. AMICO's Counterclaim was the "mirror image" of its Complaint.

VII. JUDGE WOOD DISMISSES ALL COUNTS OF AMICO'S COMPLAINT WITH LEAVE TO RE-PLEAD ONE COUNT

GTE moved to dismiss AMICO's Complaint pursuant to FRCP 12(b)(6). On August 4, 1999, the Honorable Kimba M. Wood, U.S.D.J. granted GTE's motion, dismissing each of AMICO's four counts, but with leave to re-plead Count Four relating to its Punitive Damages Defense (the "August 4, 1999 Order"). (A-17) Also, on August 4, 1999, Judge Wood dismissed AMICO's Counterclaims, but with leave to re-plead its Counterclaims relating to its Punitive Damages Defense. (A-17)

Count One of AMICO's Complaint raised the Cooperation Defense, alleging that GTE had breached the cooperation condition in the insurance policy by willfully failing to satisfy its discovery responsibilities in the *Nunn* lawsuit. In the August 4, 1999 Order, Judge Wood stated that the objectives of the cooperation clause require that the insurer "provide significant evidence that the insured has failed to cooperate." (A-13) Judge Wood concluded that an insured violates the cooperation clause only when it fails to provide evidence after specific requests to do so by an insurer. (A-13) Because AMICO failed to allege that GTE had ignored specific requests by AMICO to produce evidence in discovery in the *Nunn* lawsuit, Judge Wood dismissed Count One of AMICO's Complaint. (A-14)

Count Two of AMICO's Complaint addressed the Subrogation Defense, alleging that GTE breached the subrogation condition in the insurance policy by prejudicing AMICO's rights of subrogation against third-party defendant Falconer

Glass and GTE's co-defendants in the *Nunn* lawsuit. In the August 4, 1999 Order, Judge Wood stated that whether or not there has been a breach of a subrogation condition turns solely on whether the insured has expressly released its claims against third parties. (A-14) GTE did not enter into a written release with Falconer Glass. Judge Wood rejected AMICO's argument that the preclusive sanctions imposed against GTE in the *Nunn* lawsuit were the legal equivalent of a written release. Under the District Court's analysis, an insured is apparently free to prejudice its insurer's rights of subrogation in any manner other than a written release. (A-15)

Count Three of AMICO's Complaint, the Public Policy Defense, asserted a public policy against indemnification for the consequences of discovery sanctions. In the August 4, 1999 Order, Judge Wood admitted that she might not have dismissed the Public Policy Defense if the discovery sanctions imposed upon GTE in the *Nunn* lawsuit were monetary, as opposed to evidentiary, in nature. (A-16) Specifically, Judge Wood stated that the arguments in support of AMICO's Public Policy Defense "would have merit if GTE sought indemnification for monetary sanctions imposed upon them by Justice Gerace." (A-16) But since the sanctions were evidentiary in nature, Judge Wood dismissed Court Three of AMICO's Complaint. (A-16)

VIII. JUDGE CASEY DISMISSES THE REMAINING COUNT IN AMICO'S AMENDED COMPLAINT AND GRANTS GTE JUDGMENT ON THE PLEADINGS

Pursuant to Judge Wood's August 4, 1999 Order, AMICO filed an Amended Complaint, which re-pled its Punitive Damages Defense. GTE moved to dismiss AMICO's Amended Complaint pursuant to FRCP 12(b)(6). AMICO also filed an Amended Counterclaim on its Punitive Damages Defense in GTE's declaratory judgment action. GTE moved for judgment

on the pleadings in its declaratory judgment action pursuant to FRCP 12(c).

On September 25, 2000, the Honorable Richard C. Casey, U.S.D.J., rendered his Opinion and Order (the "September 25, 2000 Order"). (A-32) The September 25, 2000 Order granted GTE's motions to dismiss AMICO's Amended Complaint and Amended Counterclaim with prejudice, granted GTE's Motion for Judgment on the Pleadings, and awarded GTE attorney's fees and costs. (A-32)

In Count Four of AMICO's Amended Complaint, AMICO argued that the public policy of the State of New York precluded insurance coverage for punitive damages and, therefore, AMICO had no duty to indemnify GTE for that portion of the settlement of the *Nunn* lawsuit which disposed of GTE's punitive damages exposure. GTE was clearly faced with punitive damage exposure based upon the expected instruction to the jury that GTE had prior knowledge of defects in its products, but Judge Casey failed to accord proper weight to this fact. (A-30)

IX. FINAL JUDGMENT AND APPEAL TO THE SECOND CIRCUIT

Judge Casey entered an Amended Judgment on February 27, 2001 (the "February 27, 2001 Amended Judgment"). (A-7–8) In the February 27, 2001 Amended Judgment, Judge Casey ordered that GTE recover a sum of $5,524,234.62, plus post-judgment interest accruing from Entry of Judgment (October 3, 2000) through the date of payment by AMICO. (A-8)

AMICO timely filed its Notice of Appeal to the Second Circuit on March 19, 2001. On February 25, 2002, the Second Circuit entered a Summary Order affirming the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment. (A-3) The Second Circuit did not certify

any questions of law to the New York Court of Appeals. In fact, the Second Circuit did not even comment on AMICO's motion for certification of questions of law to the New York Court of Appeals. (A-3) In rendering its February 25, 2002 Summary Order, the Second Circuit concluded:

> All these arguments were analyzed in detail by the district judges. We agree with those judges that, for substantially the reasons they gave, AMICO has not set forth any valid claims under New York law. We also agree that GTE has made out its case for judgment on the pleadings and for attorneys' fees. We therefore AFFIRM the district judges' dismissal, judgment on the pleadings, and grant of attorneys' fees.

(A-3)

THE PETITION FOR WRIT OF CERTIORARI SHOULD BE GRANTED

If allowed to stand, the decision below will provide insured litigants with relative immunity from preclusive sanctions. The ruling of the District Court, affirmed by the Second Circuit, allows insured litigants to pass the financial consequences of preclusive sanctions to their insurers, making insured litigants far more willing to abuse the discovery rules. The likely result of the decision below is an increase in discovery abuses. Obviously, this raises serious questions about the ongoing ability of trial judges to command compliance with the discovery rules from those who appear before them. It also implicates concerns about the fair and efficient administration of justice in both the state and federal systems.

The District Court's ruling places the financial consequences of the likely increase in willful discovery abuses at the feet of the insurance industry. It is not possible to accurately underwrite the risk that an insured will incur preclusive sanctions due to willful discovery abuses because the consequences of a preclusive sanction are so unpredictable yet so devastating.

For example, like GTE here, an insured's willful discovery abuse might turn a very defensible claim into one with no defense. Without accurate underwriting, insurance companies will pay out more in judgments and settlements than they charge for premiums — a sure recipe for business failure. Thus, this appeal raises questions of utmost importance not only to AMICO, but also to the insurance industry as a whole.

The United States Supreme Court will grant a petition for writ of certiorari only for "compelling reasons." Rule 10 of the United States Supreme Court Rules provides in pertinent part:

> Review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only for compelling reasons.

The many compelling reasons for this Court to grant AMICO's petition for writ of certiorari are discussed in more detail below.

The Second Circuit based its February 25, 2002 Summary Order on the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment, which incorporated Judge Wood's August 4, 2000 Order as well as Judge Casey's September 25, 2000 Order. (A-3) Thus, the argument below discusses and refers to the substance of the District Court's prior Orders, Judgment, and Amended Judgment.

I. THE SECOND CIRCUIT COMMITTED ERROR BY AFFIRMING THE DISTRICT COURT'S DISMISSAL OF THE COOPERATION DEFENSE

The District Court incorrectly concluded that GTE's contractual obligation to cooperate with AMICO is triggered only by an express request for cooperation from AMICO. The District Court stated that the cooperation condition in the AMICO policy "is, by its terms, violated only when GTE

fails to, *e.g.*, give evidence, *after having been requested to do so by AMICO*." [Emphasis in original.] (A-13) Accordingly, because AMICO did not allege that GTE failed to respond to any of AMICO's explicit requests, the District Court ruled that GTE's willful discovery violations in the *Nunn* lawsuit did not constitute a breach of the cooperation condition. (A-14)

The District Court's ruling is founded upon an incorrect interpretation of the cooperation condition, which actually imposes two separate and distinct obligations. First, "the insured shall cooperate with the company. . . ." (A-13) Second, "upon the company's request, [the insured] shall attend hearings and trials and shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits." (A-13) The District Court's ruling ignored the unconditional obligation to cooperate imposed by the first clause, and relied solely upon AMICO's failure to satisfy the "request" requirement of the second clause. (A-13) This clear error warrants reversal of the District Court's dismissal of the Cooperation Defense, and the Second Circuit's affirmance thereof.

Furthermore, the decision of the District Court is internally and irreconcilably inconsistent. Even though the District Court recognized that an insurer is entitled to expect that its insured will comply with the discovery rules during the defense of covered claims (even without an express request by the insurer for compliance), the District Court's ruling provides no recourse for an insurer who is harmed by its insured's failure to so comply. Under the District Court's analysis, an insured may violate the discovery rules as long as the insurer has not cautioned the insured to comply with the discovery rules.

The District Court correctly recognized that an insurer "should not have to instruct those covered under the policy to comply with the Federal Rules of Civil Procedure." (A-13) Therefore, even under the District Court's own reasoning,

GTE's intentional concealment of documents and information in the *Nunn* lawsuit should qualify as an actionable failure to cooperate with AMICO. *Cf. Harary v. Allstate Ins. Co.*, 988 F.Supp. 93, 102 (E.D.N.Y. 1997) ("insured promises to render full and prompt assistance to discover the facts surrounding the loss and anything less results in a breach of contract"), *quoting Dyno-Bite, Inc. v. Travelers Cos.*, 439 N.Y.S.2d 558, 560-61 (N.Y.App.Div. 1981); *Blakeslee v. Royal Ins. Co. of America*, 93 Civ. 1633, 1995 WL 122724 at *5 (S.D.N.Y. March 22, 1995) (violation of the duty to cooperate "constitutes a material breach of the insurance contract and a defense to indemnification under the policy"). Nevertheless, because AMICO did not **expressly** request that GTE refrain from violating the rules of discovery, the District Court found that GTE did not breach the cooperation clause. The Second Circuit did not resolve this internal and irreconcilable inconsistency.

II. THE SECOND CIRCUIT COMMITTED ERROR BY AFFIRMING THE DISTRICT COURT'S DISMISSAL OF THE SUBROGATION DEFENSE

Although applicable New York Appellate Division precedent was established after the ruling by the District Court, the Second Circuit summarily affirmed the decision of the District Court on the Subrogation Defense for the reasons stated by the District Court in its opinion. In *Shaw v. Bronfman*, 284 A.D.2d 267, 727 N.Y.S.2nd 428 (N.Y.App.Div. 2001), the New York Appellate Division recently held that preclusive sanctions, incurred by an insured for willful discovery violations, breach the subrogation clause of an insurance policy as a matter of law. *Shaw* was decided on June 28, 2001, after the District Court had dismissed AMICO's Amended Complaint and during the appeal to the Second Circuit. Therefore, the District Court did not consider *Shaw* when dismissing AMICO's lawsuit.

AMICO's argument on the Subrogation Defense, rejected by the District Court as not supported by existing New York law or even a good faith extension of New York law, is now recognized as valid by the New York courts. In light of this intervening precedent, the Second Circuit should have reversed and remanded that portion of the District Court's decision relating to the Subrogation Defense. At a minimum, the Second Circuit should have issued an opinion explaining how, if at all, it distinguished this intervening precedent. To summarily affirm the decision of the District Court was error because the District Court did not address *Shaw*.

Shaw addressed similar facts. An insured homeowner filed suit against the architect and engineers who designed his home. During the course of litigation, the insured refused to comply with several discovery orders, forcing the trial court to enter a preclusive sanction against the insured. Because this preclusive sanction defeated the insured's claim against the architect and engineers, the court held that the insured had breached the subrogation provision in its first party property insurance policy. Therefore, the first party insurer was relieved of any duty to indemnify.

AMICO argued to the Second Circuit that the holding in *Shaw* applies to the facts of this case. During oral argument before the Second Circuit, GTE was asked whether *Shaw* had any bearing on the present case. GTE attempted to distinguish *Shaw* by noting that it involved a first party property insurance policy, while the present case deals with a third party liability insurance policy. As AMICO stated during oral argument before the Second Circuit, this is an irrelevant point of distinction because the purpose behind a subrogation clause is identical in both first party and third party insurance policies — passing the loss to the at-fault party.

In summarily affirming the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment, the Second Circuit made no mention of *Shaw*, in essence ignoring

New York precedent of which it was aware. This was clear error by the Second Circuit.

III. THE SECOND CIRCUIT COMMITTED ERROR BY AFFIRMING THE DISTRICT COURT'S DISMISSAL OF THE PUBLIC POLICY DEFENSE

The District Court's decision establishes extremely poor public policy in several ways. First, it creates perverse incentives to abuse the discovery process. Second, it creates an illogical disparity between the treatment of preclusive sanctions and monetary sanctions. Third, it allows a litigant to obtain insurance for the consequences of its own wrongdoing. Accordingly, the Second Circuit should have reversed the District Court's ruling in order to vindicate the public policy of the State of New York, as well as the public policy of judicial systems generally.

Insurance coverage for a settlement tainted by preclusive sanctions imposed for willful discovery violations, as the courts below ordered, frustrates public policy. To be sure, the sanctions regime for discovery violations implicates important public policies. For example, in *New York Funeral Chapels, Inc. v. Globe Indem. Co.*, 33 F.Supp.2d 294 (S.D.N.Y. 1999), the court identified three purposes of sanctions under Federal Rule of Civil Procedure 37: "(1) they insure that a party will not benefit from failure to comply with discovery requests, (2) they are specific deterrents in a case to a particular party, and (3) they have a general deterrent effect on the case at hand and on other litigation." *Id.* at *22 [citations, internal ellipses, and quotation marks omitted]. *See also Banco de Ponce v. Buxbaum*, 1991 U.S.Dist. LEXIS 17147 at *19 (S.D.N.Y. Nov. 27, 1991) (the "strong medicine" of preclusive sanctions must be administered in appropriate cases if Rule 37 is not to become a "paper tiger").

In view of the purposes of discovery sanctions, public policy must prohibit litigants sanctioned for intentional discovery abuses, like GTE, from passing the financial consequences of those sanctions to their insurers. The threat of court-imposed sanctions prevents most litigants from violating or abusing the rules of discovery. Eliminate that threat by means of insurance, and litigants lose the incentive to comply with discovery rules.

Stated differently, if litigants are able to pass the consequences of discovery sanctions to their insurers, then litigants will be more willing to wager that their discovery abuses will go undetected. A "moral hazard" is thereby created because the reward of prevailing in litigation through unlawful means is not offset by the financial risk of court-imposed sanctions. The logical consequence is an increase in discovery abuses by litigants, thereby preventing the fair administration of justice. This proposition holds true whether the financial consequences of discovery sanctions come in the form of a fine payable to the court or an unfavorable settlement forced by a preclusion order. The decisions below are contrary to public policy for this reason.

The decisions below are also contrary to public policy because they create a bizarre and unsound anomaly in the law. The August 4, 1999 Order makes clear that monetary sanctions are not insurable. For example, the District Court correctly stated that AMICO's Public Policy Defense "would have merit if GTE sought indemnification for monetary sanctions imposed upon them by Justice Gerace."[1] (A-16) Under

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[1] For example, in *Loigman v. Massachusetts Bay Insurance Co.*, 561 A.2d 642 (1989), the Superior Court of New Jersey found that an insurer was not required to defend an insured against a motion for sanctions in federal court because such a proceeding was punitive in nature. The Court also found that public policy prevented the appellant attorney from shifting the burden of the punitive sanctions to his insurer. The court stated that, "if the insured could have insured against the Rule 11 sanctions, strong federal

the District Court's analysis, however, while insurance coverage is not permitted for monetary sanctions, it is allowed for settlements tainted by preclusive sanctions. This rule makes no sense when applied to the real world.

Typically, minor or moderate violations of the discovery rules are punished with monetary sanctions. Only the worst and most willful of discovery abuses will prompt preclusive sanctions. From an insurance perspective, then, an insured is better off, under the District Court's analysis, if it flagrantly abuses the discovery process. For example, GTE is presently better off having committed serious discovery abuses, as opposed to only minor violations, because GTE incurred a preclusive sanction, not merely a monetary sanction. Public policy cannot support a rule that punishes minor indiscretions while rewarding egregious misconduct.

The bizarre and unsound anomaly described above results from an elevation of form over substance. Public policy should not turn upon the superficial nature of the sanction imposed. Rather, it should turn exclusively upon the conduct giving rise to the sanction (which in this case is intentional discovery abuse) and the impact of that sanction upon the underlying litigation (which in this case is an irrefutable finding of liability for undisputed damages and unfavorable settlement). Under the District Court's reasoning, however, a party who willfully violates discovery rules is prohibited from obtaining insurance for monetary sanctions imposed to punish that behavior, but is not prohibited from obtaining insurance for a settlement that is tainted by preclusive sanctions imposed to punish the **same improper behavior**. (A-16)

Finally, the analysis adopted by the District Court is contrary to public policy because it allows a litigant to benefit from its own wrongdoing. Here, for example, GTE has been

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and state policies would be undermined, encouraging only mischief." *Id.* at 646.

permitted to hide behind the settlement reached in the *Nunn* lawsuit and obtain insurance coverage for the equivalent of a "fine" for willful discovery abuses. As GTE's trial attorney perceptively observed, the preclusive sanctions amounted to a multi-million dollar "fine" levied against GTE. The damages suffered by Mr. Nunn were basically undisputed and GTE's only real defense was on the issue of liability. The unfavorable settlement, which GTE entered into after the sanctions were upheld on appeal, thus amounted to a "fine." Because the "fine" was imposed to punish GTE's willful discovery misconduct, the public policy recognized in New York and elsewhere against insurance for willful misconduct should prohibit insurance coverage. *Weissman v. First Unum Life Insurance Co.*, 44 F.Supp.2d 512, 520 (S.D.N.Y. 1999) (noting well established public policy to invalidate promises to indemnify for losses arising from wrongful conduct).

IV. THE SECOND CIRCUIT COMMITTED ERROR BY AFFIRMING THE DISTRICT COURT'S DISMISSAL OF THE PUNITIVE DAMAGES DEFENSE

It is contrary to New York public policy to permit an insurer to indemnify an insured for punitive damages. *Derechin v. State University of New York*, 963 F.2d 513, 519 (2nd Cir. 1992); *Home Insurance Co. v. American Home Products Corp.*, 902 F.2d 1111, 1113 (2nd Cir. 1990) (holding that requiring an insurer to reimburse an insured for punitive damages would violate New York state public policy); *deBruyne v. Clay*, 1999 U.S.Dist. LEXIS 15266, No. 94 Civ. 4704, 1999 WL 782481 at *5 (S.D.N.Y. Oct. 1, 1999); *Home Insurance Co. v. American Home Products Corp.*, 75 N.Y.2d 196, 200-01, 551 N.Y.S.2d 481, 483-84, 550 N.E.2d 930 (N.Y. 1990) and *Garcia v. Allcity Insurance Co.*, 244 A.D.2d 219, 219, 664 N.Y.S.2d 920, 921 (1st Dep't 1997).

The plaintiff in the *Nunn* lawsuit intended to seek punitive damages. The trial court in the Nunn lawsuit intended to in-

struct the jury that GTE had prior notice of the defects in the products, laying a foundation for punitive damages. Further, if the case had continued, punitive damages would have certainly been assessed in light of the jury instruction that GTE had prior notice of the defects in the products. In fact, GTE settled only after its exposure to punitive damages was dramatically increased as a result of the sanctions for its willful discovery violations. Thus, it is reasonable to conclude that part of GTE's settlement payment extinguished its exposure to punitive damages.

The prayer for relief in the *Nunn* lawsuit was $15,000,000 in compensatory damages. The *Nunn* lawsuit settled for $4,500,000. GTE argued and the District Court agreed that these numbers show irrefutably that GTE's settlement was strictly for compensatory damages. (A-30) This argument is flawed because virtually every lawsuit begins with an inflated prayer for damages, but settles for much less. The difference between the prayer and the settlement says little or nothing about the nature of the settlement as compensatory or punitive.

AMICO presented a reasonable argument that part of the *Nunn* settlement was for punitive damages. Whether and to what extent the settlement related to punitive damages is ultimately a fact question to be decided by a jury. Therefore, both the District Court and the Second Circuit erred in dismissing AMICO's Punitive Damages Defense.

V. THE SECOND CIRCUIT COMMITTED ERROR BY FAILING TO CERTIFY IMPORTANT QUESTIONS OF LAW TO THE NEW YORK COURT OF APPEALS

AMICO sought certification of several important questions of law to the New York Court of Appeals. Each of these questions was one of first impression and addressed important issues of insurance coverage law. The Second Circuit did not

grant AMICO's Motion for Certification. Indeed, the Second Circuit did not even comment upon AMICO's Motion for Certification when issuing its Summary Order. The Second Circuit committed error by not certifying these questions to the New York Court of Appeals and by failing to even provide AMICO with its reasons for not doing so.

CONCLUSION

The February 25, 2002 Summary Order of the Second Circuit, which affirmed the District Court's October 3, 2000 Judgment and February 27, 2001 Amended Judgment, must be reversed.

Count One of AMICO's Complaint for Declaratory Judgment and Other Relief stated a valid cause of action for breach of the cooperation condition in the AMICO policy. GTE failed to cooperate with AMICO in the defense of the *Nunn* lawsuit by intentionally withholding and concealing evidence. As the District Court observed, AMICO should not have to expressly instruct GTE to comply with the discovery rules in order to expect such compliance. More importantly, and contrary to the District Court's reading of the cooperation condition, the AMICO policy itself states that GTE must cooperate with AMICO even in the absence of an express request. Thus, the Second Circuit erred in affirming the District Court's dismissal of AMICO's Cooperation Defense.

Count Two of AMICO's Complaint for Declaratory Judgment and Other Relief stated a valid cause of action for breach of the subrogation condition of the AMICO policy. As a direct result of the preclusive sanctions against GTE for its willful discovery abuses, AMICO no longer has a right to seek full recovery from Falconer Glass (the party truly at fault) and GTE's other co-defendants in the *Nunn* lawsuit. Of course, in the absence of those sanctions, AMICO would have such a right. GTE has thus seriously prejudiced AMICO's rights of subrogation. A recent New York Appellate Division decision,

rendered after the District Court ruled, fully supports AMICO on this point but was ignored by the Second Circuit. The Second Circuit, therefore, erred in affirming the District Court's dismissal of AMICO's Subrogation Defense.

Count Three of AMICO's Complaint for Declaratory Judgment and Other Relief stated a valid cause of action based upon public policy. GTE was sanctioned for intentionally abusing the discovery process. There is no punitive component to such sanctions if GTE can insure against their direct consequences. The specific and general deterrent effects of those sanctions are nullified if GTE is allowed to pass the burden of the resulting adverse settlement of the *Nunn* lawsuit to AMICO. Because public policy should prohibit such a result, the Second Circuit should not have affirmed the District Court's dismissal of AMICO's Public Policy Defense.

Count Four of AMICO's Complaint For Declaratory Judgment and Other Relief stated a valid cause of action based upon the public policy against insurance for a settlement reflecting punitive damages. The public policy of the State of New York precludes insurance coverage for punitive damages. To the extent the amounts paid in settlement of the *Nunn* lawsuit disposed of GTE's exposure for punitive damages, AMICO should have no duty to indemnify GTE with respect to that settlement. Accordingly, the Second Circuit should not have affirmed the District Court's dismissal of AMICO's Punitive Damages Defense.

Rule 10 of the United States Supreme Court Rules grants this Court authority to grant petitions for writs for certiorari for "compelling reasons." The Second Circuit has ordered AMICO to reimburse GTE for costs stemming from its willful and intentional abuse of the discovery process. The impact of this decision upon the administration of the judicial system in every jurisdiction in this country, as well as the erosion the sanction provisions of Rule 37 of the Federal Rules of Civil Procedure and its state law counterparts, is immediate and

immense. The public policy issues raised by this appeal are alone sufficiently compelling to warrant review by this Court.

Important concerns for the insurance industry as a whole are also at stake. Insurers cannot accurately underwrite the risk that their insureds will incur preclusive sanctions for willful discovery abuses. Without sound underwriting, the viability of the insurance industry is placed in jeopardy. Also, an insurer should not be left "holding the bag" when preclusive sanctions incurred by the insured substantially impair the insurer's rights of subrogation. Without the ability to pass the loss to the party truly at fault, premiums will rise for all policyholders. Therefore, review by this Court is warranted.

WHEREFORE, for the foregoing reasons, Appellant-Petitioner, AMERICAN MOTORISTS INSURANCE COMPANY, respectfully requests that this Honorable Court grant certiorari to review the Second Circuit's February 25, 2002 Summary Order in its entirety.

Dated: May 23, 2002

Respectfully submitted,

TRESSLER, SODERSTROM, MALONEY & PRIESS

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APPENDIX

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND MAY NOT BE CITED AS PRECEDENTIAL AUTHORITY TO THIS OR ANY OTHER COURT, BUT MAY BE CALLED TO THE ATTENTION OF THIS OR ANY OTHER COURT IN A SUBSEQUENT STAGE OF THIS CASE, IN A RELATED CASE, OR IN ANY CASE FOR PURPOSES OF COLLATERAL ESTOPPEL OR RES JUDICATA.

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 25th day of February, two thousand and two.

UNITED STATES COURT OF APPEALS
FILED FEB 25 2002
Roseann B. MacKechnie, Clerk
SECOND CIRCUIT

PRESENT:

HON. AMALYA L. KEARSE,
HON. GUIDO CALABRESI,
HON. ROBERT A. KATZMANN,
Circuit Judges.

AMERICAN MOTORISTS INSURANCE COMPANY,

Plaintiff-Appellant,

v.

GTE CORPORATION,

Defendant-Appellee.

SUMMARY ORDER
01-7323

For Plaintiff-Appellant:

TODD S. SCHENK (Ngozi C. Okorafor-Johns, on the brief), Tressler, Soderstrom, Maloney & Priess, Chicago, IL. (Albert C. Hilber, Tressler, Soderstrom, Maloney & Priess, Newark, N.J., on the brief)

For Defendant-Appellee:

RICHARD D. MILONE, JR. (Heather Keele, on the brief], Gilbert, Heintz & Randolph, L.L.P., Washington, D.C.

Appeal from the United States District Court for the Southern District of New York (Kimba Wood, *J.*, and Richard Conway Casey, *J.*).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the District Court be and it hereby is AFFIRMED.

American Motorists Insurance Company ("AMICO") appeals (1) from the August 4, 1999 order of the United States District Court for the Southern District of New York (Wood, *J.*), granting GTE's motion to dismiss AMICO's Complaint under Fed. R. Civ. P. 12(b)(6), and (2) from the September 25, 2000 order and February 27, 2001 Amended Judgment of the United States District Court for the Southern District of New York (Casey, *J.*), granting GTE's motion to dismiss one repleaded count, its motion for a judgment on the pleadings, and its motion for attorney's fees. *American Motorists Ins. Co. v. GTE Corp.*, 2000 WL 1459813 (S.D.N.Y. Sept. 29, 2000). AMICO had sought a declaration that it has no responsibility to GTE for indemnification or defense costs in connection with a wrongful death lawsuit filed against GTE by the estate of Stephen R. Nunn, which eventually settled for $4.5 million.[1] AMICO denied responsibility on the ground that, prior to

[1] The estate had also sued Falconer Glass Industries, Inc., which contributed an additional $500,000 to the settlement.

the settlement, GTE had engaged in discovery violations that had led to severe preclusive sanctions being imposed on it, sanctions which, according to AMICO, compromised GTE's otherwise strong liability defense in the case. GTE also filed its own declaratory judgment action against AMICO for breach of the insurance contract. The two suits were consolidated by Judge Wood, and decided together below.

On appeal, AMICO argues that, under the terms of its insurance policy with GTE, and according to New York public policy, GTE should not be indemnified for a settlement that resulted from GTE's willful discovery violations. More specifically, AMICO contends that it has no responsibility to GTE because, by engaging in the discovery violations, GTE breached both the Cooperation Condition of its insurance policy and the policy's Subrogation Condition. Moreover, AMICO claims that New York public policy prohibits the indemnification of intentional misconduct and the indemnification of punitive damages. AMICO also contends that GTE was not entitled to attorney's fees incurred in its affirmative declaratory action.

All these arguments were analyzed in detail by the district judges. We agree with those judges that, for substantially the reasons they gave, AMICO has not set forth any valid claims under New York law. We also agree that GTE has made out its case for judgment on the pleadings and for attorney's fees. We therefore AFFIRM the district judges' dismissal, judgment on the pleadings, and grant of attorney's fees.

ROSEANN B. MACKECHNIE,
Court Clerk

By: /s/ Lucille Carr

Appendix B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMERICAN MOTORISTS INSURANCE CO.,

Plaintiff,

-against-

GTE CORPORATION,

Defendant.

99 **CIVIL** 0512 (RCC)

JUDGMENT

GTE CORPORATION,

Plaintiff,

-against-

AMERICAN MOTORISTS INSURANCE CO.,

Defendant.

99 **CIVIL** 2214 (RCC)

T S M & P

U.S. DISTRICT COURT
FILED
SEP 29 2000
S.D. OF N.Y.

RECEIVED
OCT 11 2000

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ATTY: 33-2417-7-537

GTE having moved to dismiss the complaint, the amended complaint, the counterclaim, and the amended counterclaim; GTE also having moved for judgment on the pleadings and the motions having come before the Honorable Richard C. Casey, United States District Judge, and the Court on September 25, 2000, having rendered its Opinion (84627) and Order granting GTE's motion and awarding GTE attorney's fees and costs, it is,

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Opinion (84627) and Order dated September 25, 2000, GTE's motions are granted; accordingly, American Motorists' complaint, amended complaint, counterclaim, and amended counterclaim are dismissed with prejudice and GTE is awarded attorney's fees and costs.

Dated: New York, New York
September 29, 2000

JAMES M. PARKISON
Clerk of Court

BY: /s/
Deputy Clerk

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THIS DOCUMENT WAS ENTERED ON THE DOCKET ON 10/3/00

Appendix C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMERICAN MOTORISTS INSURANCE COMPANY,
Plaintiff,
v.
GTE CORPORATION,
Defendant.

DOC # _____

CASE NO.:
99 Civ. 0512 (RCC)

AMENDED JUDGMENT

01,0400

GTE CORPORATION,
Plaintiff,
v.
AMERICAN MOTORISTS INSURANCE COMPANY,
Defendant.

CASE NO.:
99 Civ. 2214 (RCC)

AMENDED JUDGMENT

U.S. DISTRICT COURT
FILED
FEB 27 2001
S.D. OF N.Y.

On October 18, 2000, GTE Corporation ("GTE") served its motion requesting that certain clerical errors in the judgment in this matter be corrected pursuant to Rule 60(a) of the Federal Rules of Civil Procedure, or in the alternative, to alter the judgment pursuant to Rule 59(e) in order for the judgment to reflect a sum certain in favor of GTE. GTE and American Motorists Insurance Company ("AMICO") jointly request the granting of this motion. On due consideration by the court, the motion is granted.

Concurrently, GTI moved pursuant to Rule 54(d)(2)(A) of the Federal Rules of Civil Procedure for a sum certain for attorneys' fees and costs. GTE and AMICO jointly request the granting of this motion with the sum certain for attorneys' fees and costs in the amount of $139,338.35. On due consideration by the Court, the motion is granted.

Therefore, the judgment entered on October 3, 2000 is corrected and now reads:

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Opinion (84627) and Order dated September 25, 2000, GTE's motions to dismiss and for judgment on the pleadings are granted; accordingly, AMICO's complaint, amended complaint, counterclaim, and amended counterclaim are dismissed with prejudice. GTE shall recover a sum certain of $5,524,234.62, and post-judgment interest accruing at 9% per annum from Entry of Judgment (October 3, 2000) through the date of payment by AMICO. The sum certain of $5,524,234.62 to be paid by AMICO is based upon the following breakdown:

1. GTE shall recover from AMICO the sum of $4,500,000.00 for indemnity under the insurance policy.

2. GTE shall recover from AMICO the additional sum of $6,884.94 for defense costs under the insurance policy.

3. GTE shall recover from AMICO the additional sum of $878,011.33 for prejudgment interest in this matter.

4. GTE shall recover from AMICO the additional sum of $139,338.35 for attorneys' fees and costs of suit in this matter.

Dated: New York, New York
February 26, 2001

/s/ Richard Conway Casey
United States District Judge

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON 2/28/01

Appendix D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMERICAN MOTORISTS INSURANCE CO.,

Plaintiff,

-against-

99 Civ. 512 (KMW)
ORDER

GTE CORPORATION,

Defendant.

WOOD, U.S.D.J.:

Plaintiff brought this action seeking a declaratory judgment that it is not obligated to indemnify defendant under the terms of an insurance policy between the parties. Defendant has moved to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted. For the reasons stated below, the Court grants the motion to dismiss, but with leave to replead in part.

I. Background

Because the Court must, on a motion to dismiss, accept as true the factual allegations made in the complaint, *see LaBounty v. Adler*, 933 F.2d 121, 123 (2d Cir. 1991) (citations omitted), the following description of the factual background of this case is drawn from the Complaint.

Plaintiff American Motorists Insurance Corporation ("AMICO") is an Illinois corporation having its principal place of business in Long Grove, Illinois. (*See* Complaint ¶ 1.) Defendant GTE Corporation ("GTE") is a Connecticut corporation having its principal place of business in Dallas, Texas. (*See id.* ¶ 2.) Plaintiff seeks a declaratory judgment

that AMICO has no duty to reimburse GTE for costs incurred under an insurance policy.

On February 29, 1988, Mr. Stephen Nunn suffered severe, and ultimately fatal, burns in an explosion at his place of employment, Falconer Glass Industries, Inc., while attempting to repair certain electrical equipment (*See id.* ¶¶ 7, 9.) Because the explosion occurred near a GTE-manufactured switchboard, GTE was one of several defendants named in a subsequent products liability lawsuit brought by Mr. Nunn's survivors (the "*Nunn* lawsuit"). (*See id.* ¶¶ 8, 10.) A discovery dispute arose in the course of that lawsuit over whether GTE had complied with discovery demands in good faith. State Supreme Court Justice Joseph Gerace found that GTE had acted in bad faith:

> The failure of defendant GTE SYLVANIA, Inc., to comply with discovery demands . . . and its failure to comply with orders of this Court to produce requested documents and information, has been so blatant, so careless, so in disregard of the judicial process, so abusive of the corporate privileges and powers and so prejudicial to plaintiffs and the other parties in this case as to rise to the level of willful conduct justifying the relief granted by this Court.

(*See* Complaint, Exh. E, at 4.) Justice Gerace ordered that GTE would be precluded from introducing evidence to rebut plaintiff's claims of proximate cause. (*See* Complaint ¶ 28.) The result would be that the jury would assume GTE to have been negligent, leaving only the question of whether other defendants were also negligent. (*See id.*) Justice Gerace's decision was affirmed on June 10, 1998. *See Nunn v. GTE Sylvania, Inc.*, 251 A.D.2d 1089, 674 N.Y.S.2d 205 (App. Div. 4th Dep't 1998). Following this decision, the plaintiff in the *Nunn* lawsuit filed a motion for leave to amend that complaint to include a claim for punitive damages. (*See id.* ¶ 31.)

AMICO's central allegation is that, "Until the sanctions were imposed, GTE's liability defense in the *Nunn* lawsuit was very strong. After the sanctions, through no fault of AMICO, GTE's liability defense was effectively lost. (*Id.* ¶ 36.) Because of Justice Gerace's sanctions order, GTE would be held at least 50% liable for the damages suffered by plaintiff. (*See id.* ¶ 37.) In a letter dated June 23, 1998, AMICO informed GTE that it was disclaiming any duty to indemnify GTE and that it would no longer finance GTE's defense in the *Nunn* suit. (*See id.* ¶ 39.) At or around the end of 1998, GTE and another defendant settled the *Nunn* suit for $5 million dollars. (*See id.* ¶ 40.) AMICO alleges that $4.5 million of that amount came from GTE, while another defendant paid $500,000 toward the settlement. (*See id.* ¶ 41.)

AMICO thereupon brought this lawsuit, seeking a declaratory judgment that it has no obligation to reimburse GTE for amounts paid to settle the lawsuit. Count One of the Complaint alleges that GTE breached the "Cooperation Condition" of its policy with AMICO by "willfully committing discovery abuses." (*Id.* ¶ 46.) That provision states that:

> The insured shall cooperate with the company and, upon the company's request, shall attend hearings and trials and shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits. . . .

(*See id.* ¶¶ 43, 46-47; *see also* Complaint, Exh. K, General Liability Insurance Policy 3YM 578 330-00 (the "Policy"), condition 5.) Count Two of the Complaint alleges that GTE also breached the subrogation Condition of the Policy "by willfully committing discovery abuses which prompted judicial sanctions prejudicing AMICO's rights of subrogation against" GTE's co-defendants in the *Nunn* suit. The Subrogation Condition states that:

> In the event of any payment under this policy, this company will be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing, after loss[,] to prejudice such right. . . .

(*See* Complaint ¶¶ 44, 49-50; *see also* Policy, condition 9.) Count Three alleges that AMICO owes no duty to indemnify GTE because GTE's discovery abuses were willful, and New York public policy precludes insurance coverage for willful conduct. (*See id.* ¶¶ 53-55.) Finally, Count Four alleges that because New York public policy precludes insurance coverage for punitive damages, "[t]o the extent the amounts paid in settlement of the *Nunn* lawsuit disposed of GTE's exposure for punitive damages," AMICO need not indemnify GTE for that amount. (*Id.* ¶ 58.) GTE has also filed suit against AMICO seeking indemnification of the amount it paid to settle the *Nunn* lawsuit. (*See GTE Corp. v. American Motorists Insurance Co.*, 99 Civ. 2214 (KMW).)

II. Discussion

The role of a district court in considering a motion to dismiss is "not to weigh the evidence that might be presented at a trial but merely to determine whether the complaint itself is legally sufficient." *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985). The court must accept as true the factual allegations made in the complaint, *see LaBounty v. Adler*, 933 F.2d 121, 123 (2d Cir. 1991) (citations omitted), and draw all inferences in favor of the pleader. *See IUE AFL-CIO Pension Fund v. Herrmann*, 9 F.3d 1049, 1052 (2d Cir. 1993). The complaint should not be dismissed "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974) (quoting *Conley v. Gibson*,

355 U.S. 41, 45-46 (1957)); *see also Oliver Sch., Inc. v. Foley*, 930 F.2d 248, 252 (2d Cir. 1991).

A. *The Cooperation Condition*

GTE argues that AMICO cannot prevail on its claim that it violated the Cooperation Condition of the Policy because, first, that provision requires GTE to cooperate with AMICO, and there is no allegation that GTE failed to do so; and second, because AMICO has failed to plead the proper elements of a breach of a cooperation condition.

There is merit to each of GTE's arguments. First, the Cooperation Condition provides that, "[t]he insured shall cooperate *with the company*" in defending any lawsuit. *See* Complaint ¶ 43.) The Cooperation Condition sets forth no requirement that the insured must "cooperate" with the world at large. It is of course true, as AMICO points out, that AMICO should not have to instruct those covered under the policy to comply with the Federal Rules of Civil Procedure. (*See* Pl. Mem. at 4.) But the "Cooperation Condition" is, by its terms, violated only when GTE fails to, e.g., give evidence, *after having been requested to do so by AMICO*. The aim of the Cooperation Condition is to secure a mutually advantageous relationship between the parties to the policy.

In light of the goals of a cooperation clause, New York courts have required insurers to provide significant evidence that the insured has failed to cooperate. Under New York law,

> it is well settled that in order to disclaim coverage on the ground of an insured's lack of cooperation, the carrier must demonstrate that (1) it acted diligently in seeking to bring about the insured's cooperation, (2) the efforts employed by the carrier were reasonably calculated to obtain the insured's cooperation, and (3) the attitude of the insured, after his cooperation was sought, was one of willful and avowed obstruction.

Commercial Union Ins. Co. v. Burr, 226 A.D.2d 416, 417, 641 N.Y.S.2d 69, 70 (App. Div. 2d Dep't 1996) (citing *Thrasher v. United States Liab. Ins. Co.*, 19 N.Y.2d 159, 168-69, 278 N.Y.S.2d 793 (1967)); *see also Allstate Ins. Co. v. Loester*, 177 Misc. 2d 372, 374, 675 N.Y.S.2d 832, 834 (Sup. Ct. Queens Cty. 1998).

AMICO makes no effort, either in the Complaint or in its memorandum, to comply with these pleading requirements. It does not allege that AMICO requested GTE to comply with discovery demands. In its Memorandum of Law, it states that, "AMICO is making a good faith and well-reasoned argument for the logical application of existing case law to the never-before-addressed facts at bar." (Pl. Mem. at 4.) Yet AMICO cites none of this "existing case law"; its argument on this point consists of two short paragraphs without any reference to legal authority. AMICO goes on to explain that its arguments "must be resolved by a motion for summary judgment." (Pl. Mem. at 4.) Because AMICO has failed to plead a cause of action for breach of a cooperation clause, and provided no indication of what argument it would advance to support this cause of action, the Court dismisses Count One of the Complaint.

B. *The Subrogation Condition*

GTE also maintains that it has not violated the Subrogation Condition, which provides that, "The insured shall do nothing, after loss[,] to prejudice such rights" of recovery against third persons. (Complaint ¶ 44.) New York courts have emphasized that whether or not there has been a breach of a subrogation condition turns on whether the insured has released its claims against third parties. The insurer must first "establish[ ] the existence of a release, alleged to have constituted a breach of the insured's agreement not to prejudice the insurer's subrogation rights." *Weinberg v. Transamerica Ins. Co.*, 62 N.Y.2d 379, 383, 477 N.Y.S.2d 99, 101 (1984). The Complaint does not allege such a release. AMICO appears to argue that Justice

Gerace's preclusion order was equivalent to a release of third parties, because "to the extent GTE impairs its own rights, it impairs AMICO's subrogation rights." (Pl. Mem. at 5.) Yet under this theory, any litigation misstep or setback that gives an advantage to the insured's co-defendants would violate the Subrogation Clause. Once again, AMICO suggests that it need not provide any legal support for its claims now if it merely promises to do so later. (*See* Pl. Mem. at 7 ("GTE's attempts to distinguish the present matter from existing case law, then, are more appropriately reserved for a summary judgment motion.").) By signing and filing the Complaint, however, counsel for AMICO have attested that their claims "are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law." Fed. R. Civ. P. 11(b)(2). If counsel must be able to point to some basis for their claims when the Complaint is filed, then counsel must also be able to advise the Court of the basis of their argument when faced with a motion to dismiss.

Moreover, the settlement in the *Nunn* case cannot serve as a third-party release. AMICO denied coverage for any settlement amount on June 23, 1998, a few months before the *Nunn* case settled. (*See* Complaint ¶¶ 39-40.) GTE's settlement following AMICO's denial of coverage does not violate the Subrogation Clause: " [W]hen an insurer has denied coverage, the person claiming coverage may enter into a settlement with a third party without first litigating its coverage dispute with the insurer and without prejudice to its right to pursue the coverage claim against the insurer. . . ." *In re Joint Eastern & Southern Dist. Asbestos Litig.*, 78 F.3d 764, 780 (2d Cir. 1996). In *Amalgamet Inc. v. Underwriters at Lloyd's*, 724 F. Supp. 1132 (S.D.N.Y. 1989), for example, the court concluded that a release of third-party liability did not violate a subrogation clause where the release took place after the insurer denied coverage. *See id.* at 1141. Because AMICO's claim that GTE breached the Subrogation Clause fails to state the

elements of such a claim and is in any event barred by AMICO's denial of coverage, the court dismisses Count Two of the Complaint.

C. *Whether GTE's Willful Conduct Bars Indemnification*

Count Three of the Complaint contends that because New York's public policy precludes insurance coverage for willful conduct, GTE should not be indemnified for its willful discovery violations. This claim must be dismissed. The Complaint does not allege that GTE seeks indemnification for some sort of monetary sanction imposed on it for discovery violations, but for the settlement amount. AMICO makes a number of public policy arguments suggesting that insurance companies should not be forced to cover the cost of sanctions, because doing so would encourage litigants to violate the Federal Rules of Civil Procedure. (*See* Pl. Mem. at 7-9.) These arguments would have merit if GTE sought indemnification for monetary sanctions imposed upon them by Justice Gerace. GTE does not. Because the factual allegations of the Complaint do not support the legal theory of Count Three, the Court dismisses Count Three.

D. *Whether GTE Seeks Indemnification for Punitive Damages*

Count Four alleges that to the extent the amount GTE paid to settle the *Nunn* lawsuit involved punitive damages, AMICO is under no obligation to indemnify GTE for that amount. It is true that New York public policy precludes insurance coverage for punitive damages. *See Hartford Acc. & Indem. Co. v. Village of Hempstead*, 48 N.Y.2d 218, 228 422 N.Y.S.2d 47 (1979). Like AMICO's other claims, however, Count Four suffers from significant pleading defects. Although AMICO alleges that the plaintiff in the *Nunn* lawsuit filed a motion for leave to amend that complaint to include a claim for punitive damages (*see id.* ¶ 31,) AMICO does not allege that the motion was granted or that, at the time of settlement, the *Nunn*

complaint included a claim for punitive damages. AMICO fails to provide any estimate of what portion of the settlement is attributable to punitive damages, nor does it mention that the *Nunn* plaintiffs initially sought $15 million in compensatory damages (*see* Def. Mem., Exh. 1,) which raises the possibility that the settlement amount reflected only compensatory damages.

Yet it is possible that a portion of the settlement paid reflected GTE's conclusion that the preclusion order significantly increased its exposure to punitive damages. Because it does not "appear[ ] beyond a doubt that [AMICO] can prove no set of facts in support of [its] claim which would entitle [it] to relief," *Scheuer*, 416 U.S. at 236, AMICO is entitled to an opportunity to amend its pleading solely with respect to the punitive damages issue.

E. *Attorneys' Fees*

Finally, GTE seeks attorneys' fees incurred in defense of this suit, on the ground that a carrier must reimburse a policyholder when it initiates litigation. (*See* Def. Mem. at 10.) Because this request requires a definitive assessment of the merits of this controversy, the Court denies this request, without prejudice and with leave to renew upon the disposition of 99 Civ. 2214.

III. Conclusion

For the reasons stated above, the court grants GTE's motion to dismiss for failure to state a claim upon which relief can be granted, but with leave to replead solely plaintiff's claim that a portion of the settlement was based on liability for punitive damages. [Doc. No. 5.] AMICO shall file an Amended Complaint no later than September 10, 1999. The parties shall submit a Joint Scheduling Order no later than September 10, 1999, setting forth a schedule for further proceedings in this case. The Court hereby consolidates this case with 99 Civ. 2214.

SO ORDERED.

Dated: New York, New York
August 4, 1999

/s/ Kimba M. Wood

Kimba M. Wood
United States District Judge

Copies of this Order have been mailed to counsel for the parties.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

GTE CORPORATION,

Plaintiff,

-against-

AMERICAN MOTORISTS INSURANCE COMPANY,

Defendant.

99 Civ. 2214 (KMW)
ORDER

WOOD, U.S.D.J.:

This case is the mirror image of another case pending before this Court, *American Motorists Insurance Company v. GTE Corporation*, 99 Civ. 512 (KMW). For the reasons stated in the Court's Order of August 4, 1999, in 99 Civ. 512, plaintiff's motion to dismiss defendant's counterclaims is granted, except that defendant shall have leave to replead its counterclaim relating to punitive damages no later than September 10, 1999. The parties shall submit a Joint Scheduling Order no later than September 10, 1999, setting forth a schedule for further proceedings in this case. The Court hereby consolidates this case with 99 Civ. 512.

SO ORDERED.

Dated: New York, New York
August 4, 1999

/s/ Kimba M. Wood

Kimba M. Wood
United States District Judge

Copies of this Order have been mailed to counsel for the parties.

Appendix E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

AMERICAN MOTORISTS INSURANCE COMPANY,

Plaintiff,

v.

GTE CORPORATION,

Defendant.

99cv512 (RCC)

Opinion and Order

GTE CORPORATION,

Plaintiff,

v.

AMERICAN MOTORISTS INSURANCE COMPANY,

Defendant.

99cv2214 (RCC)

Opinion and Order

RICHARD CONWAY CASEY, U.S.D.J.

American Motorists Insurance Company ("American Motorists") brought this action before the Court seeking a declaratory judgment that it was not obligated to indemnify GTE Corporation ("GTE") under the terms of a commercial general liability insurance policy entered into between the parties and effective from July 1, 1986 through July 1, 1989 (the "Policy"). GTE moved to dismiss the complaint, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. By Order of the Court, dated August 4, 1999 (the "August 4 Order"), the Honorable Kimba M. Wood granted GTE's motion with respect to all claims but with leave to replead American Motorists' claim that a portion of the settlement was based on liability for punitive damages.

American Motorists subsequently moved for the entry of partial final judgment pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, or for certification of the August 4 Order for interlocutory appeal pursuant to Title 28 of the United States Code, Section 1292(b). By Order dated October 18, 1999, the Honorable Kimba M. Wood denied such motion.

American Motorists replead its punitive damages claim and has brought a counterclaim and an amended counterclaim against GTE. GTE has brought before the Court a motion to dismiss American Motorists' complaint, amended complaint, counterclaim and amended counterclaim against GTE, pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, and a motion for judgment on the pleadings, pursuant to Rule 12(c) of the Federal Rules of Civil Procedure. For the reasons stated herein, GTE's motions are GRANTED and American Motorists complaint, amended complaint, counterclaim and amended counterclaim are DISMISSED.

Jurisdiction

American Motorists is an Illinois corporation, having its principle place of business in Long Grove, Illinois. GTE is a Connecticut corporation having its principle place of business in Dallas, Texas. The Court has jurisdiction over this matter pursuant to Title 28 of the United States Code, Section 1332, based on diversity jurisdiction. Further, the amount in controversy exceeds $75,000.

Background[1]

These consolidated cases[2] refer to an earlier action, entitled *Estate of Steven R. Nunn v. GTE Sylvania, Inc., Glass Tech, Inc., B & E Electric Corp., Barnes Construction Corp., City of Jamestown Board of Public Utilities, and Trautman Assoc.*, brought in the Supreme Court of the State of New York, county of Chautauqua (the "*Nunn* lawsuit"). On February 29, 1988, Steven R. Nunn suffered burns in an explosion at his place of employment, which eventually led to his death approximately thirty (30) days after the accident. The accident involved a GTE-manufactured low voltage switchboard that had been installed by B & E Electric Corp. in 1981. A lawsuit followed, which was controlled by GTE. American Motorists agreed to provide a defense for the *Nunn* lawsuit. During the course of the lawsuit, a discovery dispute arose regarding whether GTE has complied with the court's discovery demands in good faith. State Supreme Court Justice Joseph Gerace found that GTE had acted in bad faith, imposed sanctions and ordered that GTE would be precluded from introducing evidence to rebut the *Nunn* plaintiff's claims of proximate cause. This decision was affirmed on June 10, 1998 in *Nunn v. GTE Sylvania, Inc.*, 251 A.D.2d 1089 (App. Div. 4th Dep't 1998).

Settlement discussions to dispose of the case commenced, during which GTE's trial attorney made a number of unsuccessful attempts to reach an agreement pursuant to which Falconer Glass would agree to pay a substantial majority of any verdict received, based on a preliminary estimation that Falconer Glass was the most culpable for the accident. At the

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[1] The Court omits any discussion of the facts of American Motorists' claims that were dismissed previously by the Honorable Kimba M. Wood, and only discusses the facts relevant to the Complaint and Amended Complaint, which are currently before the Court.

[2] As the Honorable Kimba M. Wood noted in the August 4 Order, American Motorists' and GTE's cases are "mirror images" of one another. Accordingly, the Court will address them together.

end of 1998, GTE and Falconer Glass settled the *Nunn* lawsuit for $5 million, pursuant to which GTE paid $4.5 million. GTE sought payment from American Motorists for such settlement, pursuant to the Policy. American Motorists thereafter brought a lawsuit seeking a declaratory judgment that it had no obligation to reimburse GTE for amounts paid to settle the lawsuit; alleging that GTE breached the "Cooperation Condition" of its policy with American Motorists by committing discovery abuses; alleging that GTE breached the Subrogation Condition of the policy by committing discovery abuses which promoted judicial sanctions prejudicing American Motorists rights; alleging that American owes no duty to indemnify GTE because New York policy precludes insurance coverage for willful conduct; and alleging that New York policy precludes insurance coverage for punitive damages, thus, American Motorists need not indemnify GTE for any amount of punitive damages.

In the August 4 Order, the Court stated correctly that New York public policy precludes insurance coverage for punitive damages. However, the Court concluded that the allegations in American Motorists' complaint suffered from significant pleading defects. Specifically, American Motorists did not allege that the *Nunn* plaintiff's motion for leave to amend the complaint to include a claim for punitive damages was granted. Further, American Motorists did not allege that the *Nunn* complaint included a claim for punitive damages at the time of settlement, nor did American Motorists provide any estimate of what portion of the settlement was attributable to punitive damages. As the Court noted in the August 4 Order, the *Nunn* plaintiffs initially sought $15 million in compensatory damages. The fact that the settlement was in the amount of $5 million, which is $10 million less than the original claim for compensatory damages, raises the distinct possibility that the $5 million settlement reflected only compensatory damages. However, because the Court determined that it did not appear clear beyond a doubt that American Motorists could

prove no set of facts in support of its claim, the Court permitted American Motorists to amend its pleading solely with respect to the punitive damages issue.

American Motorists replead its punitive damages claim, arguing in its amended complaint that the sanctions imposed upon GTE by Judge Gerace created or increased GTE's exposure to punitive damages because the jury would have been instructed that GTE had prior notice of potential defects in the switches as the time of the accident which lead to Mr. Nunn's death. American Motorists further argues that some portion of the settlement amount resolved GTE's exposure to punitive damages. In support of its claims, American Motorists alleges that GTE's trial attorney estimated that the probability of a verdict in favor of plaintiff in the *Nunn* case was 40-50%, a potential verdict range was between $2.5 million to $4 million, and that Falconer Glass was "clearly most liable for the accident." *Id.* ¶¶ 21-23. American Motorists acknowledges in its Complaint that "GTE's trial attorney also referred to unsuccessful attempts to reach an agreement in which Falconer Glass would agree to pay a substantial majority, perhaps 80%, of any verdict received. . . ." *Id.* ¶ 24. American Motorists states that it reserved its rights to disclaim coverage for the *Nunn* lawsuit because GTE breached certain conditions of the Policy. The Honorable Kimba M. Wood found that

> [i]t is well settled that in order to disclaim coverage on the ground of an insured's lack of cooperation, the carrier must demonstrate that (1) it acted diligently in seeking to bring about the insured's cooperation, (2) the efforts employed by the carrier were reasonably calculated to obtain the insured's cooperation, and (3) the attitude of the insured, after his cooperation was sought, was one of willful and avowed obstruction.

Unpublished Order, 99 Civ. 512, dated August 4, 1999, at 6-7 (citing *Commercial Union Ins. Co. v. Burr,* 226 A.D.2d 416, 417, 641 N.Y.S.2d 69, 70 (App. Div. 2d Dep't 1996) (citation

omitted)). The Court found that American Motorists made "no effort, either in the Complaint or in its memorandum, to comply with the pleading requirements . . . [and did] not allege that AMICO requested GTE to comply with discovery demands." *Id.* at 7. Accordingly, the Court dismissed the counts in the complaint that alleged willful breach of a cooperation and a subrogation clause, and American Motorists' count that alleged that GTE's willful conduct barred indemnification. In its amended complaint, American Motorists alleges that

> [u]ntil the sanctions were imposed, GTE's liability defense in the *Nunn* lawsuit was very strong. After the sanctions, through no fault of [American Motorists], GTE's liability defense was effectively lost. Until the sanctions were imposed, it was highly unlikely GTE would be held liable for at least fifty percent (50%0 of any judgment rendered by the jury in the *Nunn* lawsuit because the party truly at fault was Falconer Glass. . . . After the sanctions, through no fault of [American Motorists], GTE's cross-claims and third-party claims were either completely lost or substantially weakened.

Amended Complaint ¶¶ 36-38.

GTE has brought a motion to dismiss the amended complaint and a motion for judgment on the pleadings. American Motorists brought a counterclaim against GTE seeking a determination of the portion, if any, of the settlement payment attributed to punitive damages, declaring that public policy of the State of New York relieves American Motorists of any duty to indemnify GTE for such portion of the settlement and seeking and award of costs and fees incurred.

Standard

In order for a party to succeed on a motion to dismiss under Rule 12(b)(6), it must be clear that the plaintiff can prove no set of facts that would establish his or her claim for relief.

Conley v. Gibson, 355 U.S. 41, 45-46 (1957); *Cohen v. Koenig,* 25 F.3d 1168, 1172 (2d Cir. 1994). When making a determination of whether plaintiff can prove any set of facts which would entitle him or her to relief, a court must assume that the allegations in the complaint are true and draw all reasonable inferences in the plaintiff's favor. *Cooper v. Pate,* 378 U.S. 546, 546 (1964); *Kaluczky v. City of White Plains,* 57 F.3d 202, 206 (2d Cir. 1995). Vague and conclusory allegations are not sufficient. A complaint must "contain allegations concerning each of the material elements necessary to sustain recovery under a viable legal theory." *American Council of Learned Societies v. MacMillan, Inc.,* 1996 WL 706911, at *3.

In order for a party to succeed on a motion for judgment on the pleadings under Rule 12(c), which permits a party to move for judgment after the pleadings are closed but within such time as to not delay trial, a court must apply the same standard as on a Rule 12(b)(6) motion and "view the pleading in the light most favorable to, and draw all reasonable inferences in favor of the nonmoving party." *Davidson v. Flynn,* 32 F.3d 27, 29 (2d Cir. 1994) (quoting *Madonna v. United States,* 878 F.2d 62, 65 (2d Cir. 1989)). The Court will review GTE's motion to dismiss first, as GTE has "predicated [its 12(c) motion] upon GTE prevailing on its motion to dismiss...." GTE's Memorandum in Support of its Motion for Judgment of the Pleadings at 3.

Discussion

American Motorists claims that factual issues exist regarding whether the $5 million settlement included payment for punitive damages and what amount, if any, of such settlement was apportioned to punitive damages. In its opposition to GTE's motion for judgment on the pleadings, American Motorists claims that it assumed GTE's defense of the *Nunn* litigation for claims of compensatory damages. American Motorists Memorandum in Opposition to its Motion for Judg-

ment on the Pleadings at 5. American Motorists was informed in March of 1998 that GTE would be seeking coverage for amounts paid to eliminate its liability for punitive damages. *Id.* at 6. Accordingly, it "specifically informed GTE that any sums paid to satisfy liabilities for punitive damages were not covered under the terms and conditions of the AMICO policy" and that "punitive damages in the State of New York are not covered under a policy of insurance." *Id.* (citation omitted). There has been no allegation supporting American Motorists claim that the $5 million settlement was comprised, in part, of punitive damages. Notwithstanding GTE's knowledge that New York law does not provide for insurance coverage for punitive damages, the fact that the *Nunn* plaintiff's complaint did not include a claim for punitive damages, and the fact that the settlement was for $10 million less than the original claim for compensatory damages, the Court has no reason to believe that the $5 million settlement included payment for punitive damages.

The Court cannot encourage parties to engage in settlement discussions and negotiations, arrive at a settlement and then punish them for doing so by denying them insurance coverage that they are due pursuant to the Policy. This would go against the court system's general policy of encouraging settlements. Further, if the *Nunn* case had gone to trial and a $5 million verdict was reached and designated as compensatory damages, American Motorists would have to pay pursuant to the Policy. This would have been the case even if the award at trial was $15 million, or more. Although American Motorists argue that GTE's trial attorney, at one point, estimated that the probability of a verdict in favor of plaintiff in the *Nunn* case was 40-50%, and a potential verdict range was between $2.5 million to $4 million, it is obvious to the Court that such a statement was merely a guestimate made during the course of an involved settlement process. American Motorists' First Amended Counterclaim ¶ 23. Such predictions carry no weight in this case.

By settling the *Nunn* case in the amount of $5 million, GTE avoided the uncertainty of an outcome and award at trial. This was a "favorable outcome" for both American Motorists and GTE, especially considering the initial request for $15 million in compensatory damages. *See Waltuch v. Conticommodity Services, Inc.*, 88 F.3d 87, 96-97 (2d Cir. 1996) (discussing favorable settlements and in the context of employee indemnification). Although the *Nunn* plaintiff requested leave to amend its complaint to add a claim for punitive damages, such request was denied. American Motorists has presented no factual basis in support of its allegation that the settlement included payment of punitive damages.

The Court will not require the parties to go back and reargue this case after a binding settlement has been reached. This would thwart the intent of the parties to dispose of this case by settlement, in full satisfaction of all claims relevant to the *Nunn* litigation, and would go against the spirit of settlements, which encourage mutual agreements without going to trial. During the settlement negotiations, there was no breakdown of the settlement monies and their allocation. Therefore, any breakdown created now would result from the Court directing the parties to reargue the damages issue, which has already been decided and settled. Further and importantly, by letter dated June 23, 1998, American Motorists withdrew from its participation in the settlement process even after communicating with GTE about punitive damages in a letter dated January 9, 1998, and without requesting a breakdown of any settlement reached. The Court cannot provide a remedy for that decision. GTE's Memorandum in Support of its Motion to Dismiss at 3.

American Motorists' allegations in its complaint are vague and conclusory, and consist of estimates and predictions of what might have happened if the facts were other than they are. The allegations do not support the material elements necessary to sustain recovery under a viable legal theory and

are not sufficient to overcome even the deferential standard applied by the Court when reviewing a motion to dismiss. The Court holds that American Motorists has not stated a claim for relief and has put forth no factual allegations which demonstrate that the settlement payment included payment of punitive damages. Accordingly, GTE's motion to dismiss American Motorists' complaint, and amended complaint, and GTE's motion for judgment on the pleadings are GRANTED.

American Motorists has brought a counterclaim and an amended counterclaim against GTE, in which it argues that public policy of the State of New York precludes insurance coverage for punitive damages, therefore, American Motorists has no duty to indemnify GTE for money paid in settlement of the *Nunn* lawsuit. Accordingly, American Motorists seeks a determination that a portion of GTE's settlement money paid resolved GTE's exposure to punitive damages; a declaration that the public policy of the State of New York relieves American Motorists of any duty to indemnify GTE for that portion of the settlement; an award of costs and fees and all such further relief as the Court deems just and appropriate. For the reasons stated above, the Court finds that such relief is not warranted. American Motorists has not stated a claim upon which relief may be granted in its amended counterclaim, and is not entitled to costs and attorneys' fees or a determination regarding punitive damages. American Motorists has a duty to indemnify GTE under and according to the Policy.

GTE also seeks fees and costs. As GTE notes in its papers, when the Court granted, in part, GTE's first motion to dismiss, it denied GTE's request for costs without prejudice, stating that "this request requires a definitive assessment of the merits of this controversy." August 4 Order at 12. At this time, the Court has dismissed with prejudice all counts that American Motorists has brought against GTE. Accordingly, this issue is ripe for decision.

Under New York law, the award of attorney's fees in such a case "may not be had in an affirmative action brought by an assured to settle its rights . . . but only when [the insured] has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligation." *Cunniff v. Westfield,* 829 F.Supp. 55, 58 (E.D.N.Y. August 26, 1993) (citing *Mighty Midgets, Inc. v. Centennial Ins. Co.,* 47 N.Y.2d 12, 21, 416 N.Y.S.2d 559, 564, 389 N.E.2d 1080, 1085 (1979) (citations omitted). Here, as the Court has already held, American Motorists was obligated under the Policy to make certain payments to GTE in connection with the *Nunn* settlement. There is no merit to American Motorists' claims against GTE. American Motorists' argument that it should not be liable for costs and fees because the second of the two cases was filed by GTE and, therefore, was not a suit initiated by the insurer, similarly has no merit. As the Court held in the August 4 Order, and as this Court has confirmed, the two cases are mirror images of each other, and, indeed, GTE's case was in direct response to American Motorists attempt to avoid payment under the Policy. Accordingly, the Court grants GTE's motion to dismiss American Motorists counterclaim and amended counterclaim and awards GTE attorney's fees and costs incurred in connection with this case.

Conclusion

For the reasons stated above, GTE's motions to dismiss the complaint, the amended complaint, the counterclaim and the amended counterclaim are GRANTED. GTE's motion for judgement on the pleadings is GRANTED. Accordingly, American Motorists' complaint, amended complaint, counterclaim and amended counterclaim are DISMISSED WITH PREJUDICE. Further, GTE is awarded attorney's fees and costs, consistent with this opinion.

New York, New York
Dated: September 25, 2000

SO ORDERED,

Richard Conway Casey, U.S.D.J.

Supreme Court U.S.
FILED
JUL 1 2002
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No. 01-1740

In the

Supreme Court of the United States

AMERICAN MOTORISTS INSURANCE COMPANY,

Petitioner,

v.

GTE CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENT GTE CORPORATION

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RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Appellee-Respondent states that GTE Corporation is a wholly owned subsidiary of Verizon Communications Inc., which is a publicly held company.

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OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Appellee-Respondent, GTE Corporation ("GTE"), respectfully submits this brief in opposition to the Petition for Writ of Certiorari ("Petition") filed by Appellant-Petitioner, American Motorists Insurance Company ("AMICO").[1]

STATEMENT OF THE CASE

This case involves a straightforward insurance contract dispute, filed in federal court by AMICO under diversity jurisdiction, and litigated and decided exclusively under New York state law. The courts below ordered AMICO to provide liability coverage to GTE for a $4.5 million settlement and for defense costs that GTE paid in connection with a products liability lawsuit styled *Estate of Steven R. Nunn v. GTE Sylvania, Inc., et al.*, No. C-11012 (N.Y. Sup. Ct., Chautauqua County) ("*Nunn*").

No federal question of any kind was presented to or considered by any of the courts below. The interpretation of the insurance contract between GTE and AMICO was determined under New York law. AMICO's sole contention is that the decisions below constitute "a clear departure from current New York law" and further present "[i]mportant questions of law and public policy" that should be decided by this Court. Petition, at 2.

AMICO erroneously contends that an unusual fact that arose in the underlying *Nunn* lawsuit – discovery violations by GTE that led to preclusive sanctions – justifies departure from the normal rules of New York state insurance law. However, two judges of the United States District Court for the Southern District of New York (the Honorable Kimba M. Wood and the Honorable Richard Conway Casey), and a

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[1] AMICO is a Kemper insurance company.

panel of the United States Court of Appeals for the Second Circuit, have determined unanimously that the *Nunn* suit falls squarely within the plain terms of the insurance policy at issue.[2] The District Court and the Second Circuit quite properly declined to depart from well-established New York law, to speculate about what the public policy of the State of New York *should be*, or to rewrite the insurance contract between GTE and AMICO in order to suit AMICO's interests in this case.

AMICO itself does not dispute that the *Nunn* suit is covered under the coverage grant set forth in its policy. AMICO's disclaimer of coverage, which is based on four legal theories, stems solely from the discovery sanctions that were imposed against GTE while litigating the *Nunn* case. Each of these four legal theories was litigated extensively and rejected by the District Court. In affirming the rulings of both District Court judges, which were set forth at length in two memoranda opinions, the Second Circuit stated that AMICO's arguments were analyzed in detail by the District Court and that AMICO did not state valid claims under New York law:

> All of these arguments were analyzed in detail by the district judges. We agree with those judges that, for substantially the reasons they gave, AMICO has not set forth any valid claims under New York law.

See Appendix, at A-3.

After the Second Circuit affirmed, AMICO did not file a petition for a rehearing, nor did it move to stay issuance of the Second Circuit mandate pending AMICO's Petition to this Court. *See* Fed. R. App. P. 40; Fed. R. App. P. 41(b)(2).

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[2] *See* February 25, 2002 Summary Order of the Second Circuit, reprinted as Appendix A to AMICO's Petition; the Honorable Kimba M. Wood's August 4, 1999 Order of the District Court, reprinted as Appendix D to AMICO's Petition; the Honorable Richard Conway Casey's September 25, 2000 Order of the District Court, reprinted as Appendix E to AMICO's Petition (the entire Appendix collectively will be cited as "Appendix, at A-____").

AMICO now asks this Court to use its limited resources to review issues of state contract law and state public policy. Because such issues do not justify this Court's discretionary review, and because the two District Court judges and the three Second Circuit judges correctly applied well-settled principles of New York law, the Petition should be denied.

ARGUMENT

I. AMICO HAS FAILED TO ESTABLISH THAT THIS CASE PRESENTS ANY FACTORS THAT POTENTIALLY WOULD JUSTIFY SUPREME COURT REVIEW.

Supreme Court Rule 10 lists three "compelling reasons" that might justify review by this Court. *See* Sup. Ct. R. 10(a)-(c). In a glaring omission, AMICO does not even mention these three factors, much less attempt to argue that *any* of them apply to this case. AMICO's silence hardly is surprising. Because the District Court and the Second Circuit applied established New York state law to a basic insurance contract dispute, none of the factors that typically justify discretionary Supreme Court review is present: there is no conflict between the Second Circuit's decision and the decision of any other United States court of appeals; the Second Circuit did not decide any "important federal question;" and there is no hint of a departure from normal judicial procedure justifying exercise of this Court's supervisory powers. *See* Sup. Ct. R. 10(a)-(c). The ruling below also has no binding force outside of New York and constitutes only an application of New York law to the provisions of this particular insurance contract. This Court's review therefore is unwarranted.

II. AMICO'S PETITION ONLY RAISES QUESTIONS OF STATE LAW AND STATE PUBLIC POLICY, AND THEREFORE SHOULD BE DENIED.

It is undisputed that the issues raised by AMICO were governed by and resolved under New York state law. The lower courts properly determined that New York principles of insurance law and New York public policy do not allow AMICO to insert a "discovery violation" exclusion into the insurance contract when the language of the policy does not support such a construction.

GTE is not aware of any instance in which this Court has accepted for review a case concerning only the interpretation and application of state insurance law. Indeed, the Court has declined to review many such cases, most or all of which had a far wider impact upon litigants nationwide than this case. *See, e.g., Maryland Cas. Co. v. W.R. Grace & Co.*, 23 F.3d 617 (2d Cir. 1993) (New York law), *cert. denied*, 513 U.S. 1052 (1994); *Northern Ins. Co. of New York v. Allied Mut. Ins. Co.*, 955 F.2d 1353 (9th Cir.) (California and Washington law), *cert. denied*, 505 U.S. 1221 (1992); *Eagle-Picher Indus., Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12 (1st Cir. 1982) (Ohio and Illinois law), *cert. denied*, 460 U.S. 1028 (1983); *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981) (District of Columbia law), *cert. denied*, 455 U.S. 1007 (1982); *Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980) (Illinois and New Jersey law), *clarified on reh'g*, 657 F.2d 814 (6th Cir.), *cert. denied*, 454 U.S. 1109 (1981).

This Court also repeatedly has emphasized that it does not review lower federal courts' determinations of state law in diversity cases. *See Huddleston v. Dwyer*, 322 U.S. 232, 237 (1944) ("[O]rdinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts."). Even where the Court has granted review on *other* issues, it uniformly defers to the United States courts of appeal on issues of state law within their jurisdictional reach. *See Brockett v. Spokane Arcades, Inc.*, 472 U.S. 491, 499-500 (1985); *Butner v. United States*,

440 U.S. 48, 57-58 (1979). Indeed, this Court has emphasized that, "standing alone, a challenge to state-law determinations by the Court of Appeals will rarely constitute an appropriate subject of this Court's review." *Haring v. Prosise*, 462 U.S. 306, 314 n.8 (1983) (citing prior Sup. Ct. R. 17). Accordingly, Supreme Court review is not warranted because this case turns solely upon the interpretation of an insurance contract under New York law.

III. THE LOWER COURTS CORRECTLY DISMISSED EACH OF AMICO'S FOUR CLAIMS.

AMICO does not dispute that it failed to plead the legal elements of its four claims under existing New York law. Therefore, as explained below, the lower courts' unanimous rejection of AMICO's position was a correct application of settled principles of New York law to the terms of the insurance contract at issue in this case. Not only are there no compelling issues that are worthy of this Court's review, the decisions below also undoubtedly are correct as a matter of state law.

A. The District Court and the Second Circuit Properly Rejected AMICO's Argument that GTE Violated the "Cooperation Condition."

AMICO asserts that GTE violated the "Cooperation Condition" of the insurance policy by engaging in discovery violations while defending the underlying *Nunn* lawsuit. However, this argument is belied by the language of the policy itself, and by well-settled New York law setting forth the elements that must be plead in order to establish a breach of this policy condition. *See* Appendix, at A-13 to A-14.

The policy language requires that GTE cooperate *with AMICO*, not with third persons such as the underlying *Nunn* plaintiffs who are not parties to the insurance contract. *See id.* AMICO concedes that it did not and could not allege a

breach of the duty to cooperate *with AMICO*. Therefore, AMICO has not stated a valid claim.

New York law requires that an insurer plead three elements in order to allege a breach of the "Cooperation Condition": (1) the insurer acted diligently in seeking to bring about the policyholder's cooperation; (2) the insurer's efforts were reasonably calculated to obtain the policyholder's cooperation; and (3) the attitude of the policyholder, after its cooperation was sought, was one of "willful and avowed obstruction." *See id.* (citing *Thrasher v. United States Liab. Ins. Co.*, 225 N.E.2d 503, 508 (N.Y. 1967)); *see also New York City Hous. Auth. v. Housing Auth. Risk Retention Group, Inc.*, 203 F.3d 145, 151-52 (2d Cir. 2000) (citing *Thrasher*). As observed by the District Court, it is undisputed that AMICO made no effort to comply with these pleading requirements. *See* Appendix, at A-14. Consequently, there is no merit to AMICO's "Cooperation Condition" argument.

B. The District Court and the Second Circuit Properly Rejected AMICO's Argument that GTE Violated the "Subrogation Condition."

AMICO contends that GTE violated the "Subrogation Condition" of the policy, which states that GTE "shall do nothing, after loss to prejudice [AMICO's] rights" of subrogation against third parties. Petition, at 7. In rejecting this argument, the District Court and the Second Circuit followed well-settled New York law, which requires that an insurer, in order to allege a viable "Subrogation Condition" claim, must plead and establish the existence of a release given by the insured to the allegedly liable third party. *See* Appendix, at A-14 (quoting *Weinberg v. Transamerica Ins. Co.*, 465 N.E.2d 819, 821 (N.Y. 1984)). It is undisputed that AMICO failed to allege this necessary element of its claim. *See id.* at A-14 to A-15.

AMICO contends that the Second Circuit failed to give adequate consideration to the New York Appellate Division's decision in *Shaw v. Bronfman*, 727 N.Y.S.2d 428 (N.Y. App. Div. 2001). However, as AMICO acknowledges, the *Shaw*

case was addressed in the Second Circuit and distinguished by GTE. *See* Petition, at 19. Indeed, although GTE cited *Shaw* in its Second Circuit brief, *see* Brief for Defendant-Appellee, at 33 n.8, AMICO did not cite *Shaw* in any brief that it filed in the Second Circuit, including its reply to GTE's brief, which cited *Shaw*. It is remarkable that AMICO would criticize the Second Circuit's opinion for not expressly citing and rejecting *Shaw*, when AMICO itself failed to mention *Shaw* in its own briefing.[3]

C. The District Court and the Second Circuit Properly Rejected AMICO's "Public Policy" Argument.

AMICO recognizes that New York public policy only bars coverage if the policyholder specifically intended to cause the underlying plaintiff's injuries giving rise to the tort claim. *See Weissmann v. First UNUM Life Ins. Co.*, 44 F. Supp. 2d 512, 519 (S.D.N.Y. 1999). AMICO nonetheless maintains that New York public policy should be changed to bar coverage for settlements paid to underlying plaintiffs where the settlement is preceded by discovery violations in the underlying case.

In spite of AMICO's argument, there is no dispute that GTE's $4.5 million settlement payment was made to the estate of Mr. Nunn as *damages* for his *injuries* and death. There also is no dispute that AMICO's policy covers payments

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[3] Due to the unusual procedural posture in *Shaw*, the first party property insurer actually was an adverse party to the policyholder in the principal tort action against the allegedly liable third party, during which the policyholder committed the discovery violations. *See* 727 N.Y.S.2d at 428. Therefore, the carrier had no opportunity to learn about the violations or prevent them until it was too late. Here, AMICO, a third party liability insurer, was aligned with GTE and had been funding the defense of the *Nunn* litigation for GTE for nearly ten years when the violations occurred. Based upon this distinction, which was discussed at oral argument, the Second Circuit declined to follow *Shaw*. The Second Circuit's decision was a reasonable interpretation of New York law as applied to the facts of this case.

made by GTE as damages for "Bodily Injury [or] . . . Personal Injury . . . arising out of an occurrence anywhere in the world during the policy period." Brief of Defendant-Appellee, at 5 (quoting AMICO Policy, at 1). AMICO cites no authority for the proposition that the settlement payment by GTE falls outside the language of this insuring agreement, and that the payment instead is the equivalent of a sanction or fine paid to a court, merely because the payment was preceded by an adverse pretrial ruling. To the contrary, the very case cited by AMICO holds that New York courts will not rewrite the language of insurance policies to conform to an insurance company's own after-the-fact views of public policy. *See Weissmann*, 44 F. Supp. 2d at 519 (cited at page 23 of AMICO's Petition) (declining to apply public policy considerations to bar coverage where policyholder was alleged to have committed criminal acts but those acts did not contribute to damages to which insurance applied). Accordingly, the District Court and the Second Circuit properly rejected AMICO's public policy argument.

D. The District Court and the Second Circuit Properly Rejected AMICO's "Punitive Damages" Argument.

AMICO's claim that at least part of GTE's $4.5 million settlement payment went towards the payment of punitive damages cannot be reconciled with the undisputed fact that *the underlying Nunn lawsuit never even contained a claim for punitive damages*. *See* Appendix, at A-28 to A-29. Although the plaintiffs' counsel in *Nunn* indicated his intent to amend the complaint to include such a claim, leave to make such an amendment never was granted. *See* Appendix, at A-29. Thus, as observed by both District Court judges, with whom the Second Circuit agreed, AMICO's punitive damages argument is based on pure conjecture. *See* Appendix, at A-16 to A-17, A-29.

AMICO's argument also cannot be reconciled with the undisputed fact that the *Nunn* complaint sought $15 million in compensatory damages, $10.5 million less than GTE ultimately paid in settlement of the claim. *See* Appendix, at

A-23 to A-29. As Judge Casey noted, "[t]his was a 'favorable outcome' for both American Motorists and GTE." Appendix, at A-29. Accordingly, AMICO's punitive damages argument properly was rejected as well.

E. The Second Circuit Was Not Required To Certify AMICO's Appeal to the New York Court of Appeals.

In the Second Circuit, AMICO unsuccessfully sought to have *every one* of its four legal arguments certified to the New York Court of Appeals. The Second Circuit's decision not to certify was well within its broad discretion, as certification of a question of New York state law is purely discretionary. *See* 2d Cir. R. § 0.27 ("[T]his Court *may* certify to the highest court of a state an unsettled and significant question of state law.") (emphasis added). As both the District Court and the Second Circuit recognized, the questions of state law in this case are well settled and compelled rejection of the arguments raised by AMICO. Moreover, AMICO failed to establish that its own after-the-fact views of public policy warranted rewriting the plain language of its insurance policy. Accordingly, the Second Circuit did not commit error by declining to send this matter to the New York courts for yet another round of litigation.

CONCLUSION

AMICO has failed to discuss, much less satisfy, any of the criteria normally used to determine whether Supreme Court review is warranted. AMICO instead has sought review of an insurance contract dispute governed by and decided under New York state law. There are no compelling reasons for review, and AMICO's Petition should be denied.

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No. 01-1740

In the

Supreme Court of the United States

AMERICAN MOTORISTS INSURANCE COMPANY,

Petitioner,

v.

GTE CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI FROM THE SUMMARY ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT ENTERED FEBRUARY 25, 2002

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Appellant-Petitioner American Motorists Insurance Company ("AMICO") respectfully submits this reply to the brief filed by Appellee-Respondent, GTE Corporation ("GTE") in opposition to AMICO's Petition for Writ of Certiorari ("Brief in Opposition").

ARGUMENT

I. THIS COURT'S REVIEW IS NEITHER LIMITED TO, NOR CONTROLLED BY, THE ILLUSTRATIVE EXAMPLES OF "COMPELLING REASONS" SET FORTH IN SUPREME COURT RULE 10 (a)-(c)

GTE protests that AMICO has failed to address any of the three "compelling reasons" enumerated in Supreme Court Rule 10. *See* Brief in Opposition at 3. While Rule 10 (a)-(c) provides some illustrations of the types of "compelling reasons" that justify this Court's grant of a writ of certiorari, these illustrations neither control nor fully measure the Court's discretion, as Rule 10 makes clear. *See* Sup.Ct.R. 10. Consequently, AMICO was not obligated to discuss the examples set forth in Rule 10 (a)-(c) in its petition, and any reliance that GTE places on AMICO's decision not to do so as a basis to oppose AMICO's petition is misplaced and should be dismissed outright.

As AMICO's petition and reply brief make clear, this case presents issues of law and public policy that are every bit as "compelling" as those examples provided in Rule 10 (a)-(c). Therefore, this Court's review of this case is warranted and AMICO's petition for certiorari should be granted.

II. THE SECOND CIRCUIT'S DISREGARD OF CONTROLLING NEW YORK LAW WARRANTS THIS COURT'S REVIEW OF THIS CASE

GTE reasons that, because this case involves questions of state law and state public policy, this Court's review is unwarranted. *See* Brief in Opposition at 4. On the contrary, "this Court has not hesitated to decide questions of state law when necessary for the disposition of a case brought to it for decision, although the highest court of the state ha[s] not answered them, the answers [are] difficult, and the character of the answers which the highest state courts might ultimately give [remains] uncertain." *Meredith v. Winter Haven*, 320 U.S. 228, 237 (1943). Indeed, this Court has reviewed many such questions of state law. *See, e.g., Wichita Royalty Co. v. City Nat'l Bank*, 306 U.S. 103 (1939); *Six Cos. v. Joint Highway Dist.*, 311 U.S. 180 (1940); *Stoner v. New York Life Ins. Co.*, 311 U.S. 464 (1940); *Cole v. Richardson*, 405 U.S. 676 (1972); *Leavitt v. Jane L.*, 518 U.S. 137 (1996).

Ironically, GTE relies on *Brockett v. Spokane Arcades, Inc.*, 472 U.S. 491 (1985) — in which this Court found that the lower court of appeals ***erred*** in invalidating a state statute — for the proposition that this Court will "uniformly defer" to a federal court of appeals' construction of the law of a state within its jurisdiction. Accordingly, GTE contends that this Court will not review a lower federal court's determination of state law in diversity cases. *See* Brief in Opposition at 4. GTE is mistaken. Curiously absent from GTE's brief is the portion of *Brockett* wherein this Court emphasized that such a rule "is not ironclad." *Id.* at 500. Rather, this Court has acknowledged that it "surely [has] the authority to differ with the lower federal courts" as to their interpretation of state law. *Id.* This Court's reversal of the court of appeals in *Brockett* clearly demonstrates this principle.

As this Court has explained:

> If, as we have said, the courts of appeals owe no deference to district court adjudications of state law ... surely there is no basis for regarding panels of circuit judges as "better qualified" than we to pass on such questions... . Our general presumption that courts of appeals correctly decide questions of state law reflects a judgment as to the utility of reviewing them in most cases ... not a belief that the courts of appeals have some natural advantage in this domain... . That general presumption is obviously inapplicable where the court of appeals' state-law ruling is plainly wrong... .

Leavitt, 518 U.S. at 145 (citations omitted). This Court can and should review the important questions of state law and public policy presented here, given the potential harm to the judicial system threatened by the rulings of the courts below.

Further, while the issues presented in this case emanate from the contract law and public policy of the State of New York, AMICO is not asking this Court only to determine whether the Second Circuit correctly applied New York law. AMICO is also asking this Court to determine whether any federal court of appeal sitting in diversity can disregard the controlling law of the state that it is obligated to apply.

As discussed in AMICO's original petition, AMICO filed a four-count Complaint for Declaratory Judgment and Other Relief against GTE in the District Court, seeking a declaration that it was under no obligation to provide GTE defense or indemnity in the underlying products liability lawsuit styled as *Estate of Steven R. Nunn v. GTE Sylvania, Inc., et al.*, No. C-11012 (N.Y.Sup.Ct., Chautauqua County) (the "*Nunn* lawsuit"). In Count Two, AMICO asserted that GTE had breached the subrogation condition in its insurance policy because the

preclusive sanction issued against GTE for its willful discovery violations had prejudiced AMICO's rights of subrogation against GTE's co-defendants ("Subrogation Defense").

On August 4, 1999, the District Court granted GTE's motion to dismiss AMICO's complaint pursuant to FRCP 12(b)(6). (A-9 to A-18). Specifically, the District Court rejected AMICO's Subrogation Defense on the basis that it was not supported by existing New York law, or even an extension thereof. (A-14 to A-15). However, on June 28, 2001, the New York Appellate Division issued its decision in *Shaw v. Bronfman*, 284 A.D.2d 267, 727 N.Y.S.2d 428 (N.Y. App. Div. 2001), which established New York precedent supporting AMICO's Subrogation Defense.

In *Shaw*, a decision involving analogous facts, the court found that preclusive sanctions entered against a policyholder for willful discovery violations compromised the insurer's ability to bring a subrogation claim against those third parties believed to be truly at-fault. As a result, the *Shaw* court found that the policyholder had violated the subrogation clause contained in its policy, and concluded that the insurer was therefore relieved of any obligation to indemnify the policyholder.

Because the New York Appellate Division decided *Shaw* over one year ***after*** the District Court dismissed AMICO's Complaint, the District Court did not have *Shaw* to guide it when predicting New York law. AMICO emphasized the importance of *Shaw* during its oral argument before the Second Circuit and read the citation of the case into the record. AMICO argued to the Second Circuit that the holding in *Shaw* was directly applicable to the facts of this case and that, in light of this intervening precedent, the Second Circuit should reverse and remand that portion of the District Court's decision that related to AMICO's Subrogation Defense. Rather than recognize *Shaw* for the intervening precedent that it was, however, the Second Circuit summarily affirmed

the District Court's October 3, 2000 Judgment and its February 27, 2001 Amended Judgment "for substantially the reasons" that the District Court had given. (A-3).

In its opposition, GTE contends that the Second Circuit ***declined*** to follow *Shaw*. *See* Brief in Opposition at 7, n 3. This assertion is pure conjecture and should be ignored. Since the Second Circuit never issued a written opinion, it is impossible for GTE to credibly assert that the Second Circuit declined to follow *Shaw*. In fact, given that the Second Circuit affirmed "for substantially the reasons" given by the District Court — and the District Court could not possibly have considered *Shaw* — it is far more reasonable to conclude that the Second Circuit did not even consider the relevance of *Shaw*.

More importantly, the Second Circuit did not have the authority to decline to follow *Shaw*. This Court has long recognized that, in deciding questions of state law in diversity cases, a federal court is obligated to identify and apply controlling state law. *See Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938). In identifying the controlling law of a state, a federal court will look to the pronouncements of that state's highest court. *See Id.* Where the state's highest court has not yet spoken, a federal court must look to the controlling law from that state's appellate courts. *See Stoner*, 311 U.S. at 467; *Six Cos*, 311 U.S. at 188. Thus, a federal court is not at liberty to ignore applicable precedent, particularly when such precedent is brought to the court's attention.

The Second Circuit was obligated to address *Shaw*, an intervening decision rendered by a New York Appellate Court on analogous facts and an identical legal issue that unambiguously supports AMICO's Subrogation Defense.[1] Despite

[1] In asserting that the District Court and Second Circuit properly rejected AMICO's Subrogation Defense, GTE contends that AMICO failed to plead the "necessary element" of the existence of a release given by the insured to the allegedly liable third-party. *See* GTE's Opposition to Petition, page 6. Because GTE cited *Shaw*, it is aware that the New York

AMICO having expressly brought the decision to the court's attention at oral argument, the Second Circuit made no mention whatsoever of *Shaw* in its summary order.

This Court has emphasized, "[t]o be sure, we do not normally grant petitions for certiorari solely to review what purports to be an application of state law; but we have done so ... **and undoubtedly should do so where the alternative is allowing blatant federal-court nullification of state law.**" *Leavitt*, 518 U.S. at 144-145 (citations omitted) (emphasis added). The Second Circuit's indifference to the controlling and applicable state authority that it was obligated to apply is exactly the type of federal-court nullification that warrants this Court's review, reversal and remand.

III. THIS COURT'S REVIEW OF THIS CASE IS APPROPRIATE BECAUSE THE SECOND CIRCUIT IMPROPERLY DISMISSED AMICO'S FOUR COUNT COMPLAINT

The Second Circuit also erred when it affirmed the dismissal of AMICO's Cooperation Defense. GTE maintains that the District Court and the Second Circuit properly rejected AMICO's Cooperation Defense because AMICO did not plead the elements for a cause of action of breach of an insurance contract's cooperation clause, as it currently exists under New York law. *See* Brief in Opposition at 5. However, the District Court and the Second Circuit failed to appreciate that AMICO never wished to assert a claim for breach of the cooperation clause under existing New York law. Instead, AMICO urged the District Court and the Second Circuit to

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Appellate Division clearly found that the policyholder's discovery abuses and preclusive sanctions in *Shaw* prejudiced the insurer's subrogation rights despite the absence of a release given by the policyholder to the allegedly liable third party. It is unclear how GTE can find the existence of a release to be a necessary element for a cause of action based upon breach of the subrogation provision when the New York Appellate Division did not find it so.

recognize a logical extension of the law to circumstances in which a policyholder willfully abuses state or federal rules of civil procedure, as the trial court determined that GTE had done in the underlying *Nunn* lawsuit. Failing to appreciate this distinction, the District Court insisted that AMICO slavishly allege the elements of the cause of action, as it currently exists. Because AMICO did not do so, the District Court dismissed AMICO's Cooperation Defense. (A-14).

Significantly, in its August 14, 1999 order dismissing AMICO's complaint, the District Court itself acknowledged that AMICO is entitled to expect its policyholders to abide by the Federal Rules of Civil Procedure. (A-13). Yet, in dismissing AMICO's Cooperation Defense, the District Court has denied AMICO any recourse against those policyholders that willfully refuse to do so. This inconsistency is irreconcilable. The Second Circuit denied AMICO the opportunity to make a good faith argument for an extension of law on this issue when it affirmed the District Court's dismissal of AMICO's Cooperation Defense. This error justifies this Court's review.

In addition, the Second Circuit erred by affirming the District Court's dismissal of AMICO's Public Policy Defense. This error is particularly disconcerting in light of the repercussions the District Court's dismissal, and the Second Circuit's affirmance of same, will have on New York's judicial system. GTE asserts that the lower courts properly dismissed AMICO's Public Policy Defense because AMICO was using the defense to change New York public policy. *See* Brief in Opposition at 7. GTE's argument has no merit. AMICO never sought to change New York public policy, but rather, extend public policy to a situation that desperately deserves it. There is no question that sanctions are punitive, whether they are monetary or preclusive in nature. By dismissing AMICO's Public Policy Defense, however, the District Court created an unwarranted distinction between monetary and preclusive

sanctions, the insurability of which turns on the superficial nature of the sanction imposed. An increase in discovery abuses by insured litigants in New York — and perhaps elsewhere —is the logical consequence of the decisions below, and poor public policy.

Furthermore, it is obvious that GTE's settlement of the *Nunn* lawsuit was tainted by the preclusive sanctions imposed against it for its willful discovery abuses. GTE entered into its settlement with the claimant after the New York Appellate Division affirmed the preclusive sanctions that the trial court had imposed upon GTE in the underlying *Nunn* lawsuit, a determination that GTE understatedly characterizes as an "adverse pretrial ruling." Brief in Opposition at 8. Insurance coverage for a settlement tainted by such egregious discovery abuses frustrates public policy, and it was error for the Second Circuit and District Court to find otherwise.

For similar reasons, GTE is disingenuous when it maintains that its $4.5 million settlement with the claimant did not have a punitive damage component. *See* Brief in Opposition at 8. GTE does not deny that it entered into its settlement with the claimant after the trial court had imposed preclusive sanctions upon GTE, sanctions which included a jury instruction that would have laid the foundation for a punitive damage award. Nor can GTE deny that it settled with the claimant only after counsel for the claimant had made his intentions to seek punitive damages known. At the very least, the nature of GTE's settlement presents questions of fact as to whether GTE's settlement was, to some degree, punitive in nature. As a result, AMICO was entitled to present its Punitive Damages Defense to a jury. The District Court and the Second Circuit dismissed AMICO's Punitive Damage Defense before it had the opportunity to do so. This Court's review is appropriate in light of such error.

IV. THE SECOND CIRCUIT'S INDIFFERENCE TO AMICO'S REQUEST FOR CERTIFICATION IS PLAIN ERROR THAT JUSTIFIES THIS COURT'S REVIEW

As AMICO's original petition and reply brief make clear, the four defenses that AMICO raised in this case present important questions of law that are anything but "well-settled." Brief in Opposition at 9. Recognizing the significance of these questions of law, AMICO requested that the Second Circuit certify the questions to the New York Court of Appeals for its consideration. According to GTE, the Second Circuit decided not to certify AMICO's questions on the basis that they involve well-settled legal principles. *See* Brief in Opposition at 9. GTE's representation is again unsupported conjecture. A review of the Second Circuit's three page summary order demonstrates that the Second Circuit did not ***decline*** to certify the questions of law, but, rather, disregarded AMICO's request altogether. The Second Circuit should have certified these questions to the New York Court of Appeals. At the very least, it should have expressly denied AMICO's request. It did neither. This indifference to AMICO's request is error that requires this Court's review, reversal and remand.

CONCLUSION

By affirming the District Court's dismissal of AMICO's Complaint for Declaratory Judgment and Other Relief for substantially the same reasons as those provided by the District Court, the Second Circuit ignored controlling New York authority. In doing so, the Second Circuit violated the well-established principles of judicial review. As such, this Court's review of this case is warranted.

Furthermore, by affirming the District Court's ruling, the Second Circuit has contributed to the creation of extremely poor public policy that will allow policyholders to pass the consequences of discovery sanctions to their insurance

carriers. Because the District Court and Second Circuit's approval of such conduct vitiates the very purpose of preclusive sanctions, which is to deter wrongful conduct, the lower courts have opened the door to a potential onslaught of discovery abuses by policyholders throughout the country. These compelling circumstances warrant this Court's review of this case. Accordingly, AMICO respectfully urges this Court to grant its petition for writ of certiorari.

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Respectfully submitted,

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